

STUDIES IN PUBLIC WELFARE

PAPER No. 7

ISSUES IN THE COORDINATION OF PUBLIC WELFARE PROGRAMS

A VOLUME OF STUDIES

PREPARED FOR THE USE OF THE
SUBCOMMITTEE ON FISCAL POLICY

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LETTERS OF TRANSMITTAL

JUNE 28, 1973.

To the members of the Joint Economic Committee:

Transmitted herewith is a volume of studies entitled "Issues in the Coordination of Public Welfare Programs." This is paper No. 7 in the series *Studies in Public Welfare*, and was prepared as part of the subcommittee's study of the Nation's welfare-related programs.

The views expressed in these studies are those of the authors and do not necessarily represent the views of the Subcommittee on Fiscal Policy, the Joint Economic Committee, or its staff.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

JUNE 26, 1973.

HON. WRIGHT PATMAN,
*Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.*

DEAR MR. CHAIRMAN: Transmitted herewith is a volume of studies entitled "Issues in the Coordination of Public Welfare Programs," prepared in conjunction with the subcommittee's public welfare study. It focuses on how closely interrelated many of these programs are, and therefore how it frequently is necessary to reform or change several programs together rather than separately in order to achieve desired improvements.

There are three main themes in this volume:

How can social insurance programs be integrated with programs based explicitly on need so that a worker's (or his employer's) contributions in every case "buy" him future benefits that at least equal or preferably exceed what a nonworker or noncontributor receives from need-based assistance programs?

How can programs based on need and scaled down as earnings increase be coordinated so that recipients of several such programs still can achieve a financial gain from work?

How can benefits be distributed more equitably?

There are basically only a small number of alternative approaches to welfare reform, each of which having many variants. In considering program integration issues, variants of three of these basic approaches to reform were chosen to provide a focus for the papers in this volume. These program proposals do not necessarily represent the subcommittee's welfare reform preferences. They are: (1) the House-passed version of the Family Assistance Plan (1971) as contained in H.R. 1; (2) the Senate Finance Committee's version of H.R. 1 (1972); and (3) the demogrant, i.e., a flat grant payable to everyone in the population.

Most authors were requested to consider the coordination issues in current programs and the issues that would arise under each of the three basic alternative structures mentioned above. The major programs covered include the old age insurance portion of social security, unemployment insurance, medicaid and medicare, child care, and State supplementation of basic Federal welfare benefits.

The recommendations which each author makes do not carry the endorsement of the Subcommittee on Fiscal Policy, the Joint Economic Committee, individual members thereof, or its staff. The main value of the papers, in my judgment, is the exploration of the issues involved in developing a rational, well-coordinated system of programs which embody the goals of efficiency, adequacy, equity, and work incentives. As will be seen, it is much easier to wish for fulfillment of these goals than it is to achieve them all simultaneously. Difficult choices must be made among these competing objectives, each of which has merit.

This volume was compiled and edited by Alair A. Townsend, Irene Cox, Robert I. Lerman, Jon H. Goldstein, and James R. Storey of the subcommittee staff. Research assistance was provided by Mary Beth Curry, a former staff member.

MARTHA W. GRIFFITHS,
Chairman, Subcommittee on Fiscal Policy.

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INTRODUCTION: AN OVERVIEW OF ISSUES IN THE COORDINATION OF PUBLIC WELFARE PROGRAMS

By ALAIR A. TOWNSEND*

Previous staff studies have enumerated and described the multitude of Federal, State, and local public welfare programs offering aid in the form of cash, food, medical care, housing, and other services;¹ analyzed how the benefits are distributed;² considered the financial rewards they offer recipients who work or save;³ and discussed the problems in their administration.⁴ The programs were found to be inefficient, to offer poor social and economic incentives, to provide too little to many and yet too much to some whose total benefit packages are very large—larger than the amount that could be provided on an equitable basis to everyone in similar need, and sometimes higher than the local median wage.

This volume contains six studies which address some of the problems of how to make a system out of this group of programs. The major problems dealt with are the following:

How can social insurance programs be integrated with welfare programs based explicitly on need so that a worker's (or his employer's) contributions in every case "buy" him future benefits that exceed what a nonworker or noncontributor would be entitled to under need-based assistance programs?

How can programs explicitly based on need maintain financial incentives for recipients to work, especially for persons receiving benefits under several programs?

How can benefits be distributed more equitably?

The programs covered here are Federal-State public assistance (aid to families with dependent children, old age assistance, aid to the

*The author is technical director, Subcommittee on Fiscal Policy. The comments of Robert I. Lerman, Theodore R. Marmor, Robert Harris, and James R. Storey are gratefully acknowledged.

¹ Irene Cox, *Handbook of Public Income Transfer Programs*, prepared for the Subcommittee on Fiscal Policy of the Joint Economic Committee (Washington, D.C.: Government Printing Office, Oct. 16, 1972).

² James R. Storey, *Public Income Transfer Programs: The Incidence of Multiple Benefits and the Issues Raised by Their Receipt*, prepared for the Subcommittee on Fiscal Policy of the Joint Economic Committee (Washington, D.C.: Government Printing Office, Apr. 10, 1972); and James R. Storey, Alair A. Townsend, and Irene Cox, *How Public Welfare Benefits are Distributed in Low-Income Areas*, prepared for the Subcommittee on Fiscal Policy of the Joint Economic Committee (Washington, D.C.: Government Printing Office, Mar. 26, 1973).

³ See papers by Leonard Hausman, Robert Lerman, and Thad Mirer in *Income Transfer Programs: How They Tax the Poor*, prepared for the Subcommittee on Fiscal Policy of the Joint Economic Committee (Washington, D.C.: Government Printing Office, Dec. 22, 1972).

⁴ See Sharon Galm, *Welfare—An Administrative Nightmare*, Dec. 31, 1972; Joel F. Handler, et al., *Intergovernmental Relationships*, Mar. 12, 1973; and David N. Kershaw, et al., *Implications of the Income Maintenance Experiments*, Mar. 12, 1973, prepared for the Subcommittee on Fiscal Policy of the Joint Economic Committee (Washington, D.C.: U.S. Government Printing Office).

permanently and totally disabled, aid to the blind), child care, medicaid and medicare, unemployment insurance, and social security (old age insurance). Most of the six authors represented were asked to critique these existing programs, with special emphasis given to how the specific program(s) on which they focused currently mesh with other types of income maintenance programs. Additionally, they were asked to consider what changes in the program(s) of focus would be desirable under each of three alternative types of basic welfare reform plans (described below).

The recommendations which each author makes are very much their own, and do not necessarily carry the endorsement of the subcommittee or its staff. The main value of the papers, for our purposes, is the analysis of how programs interact currently and how they would interact under three alternative welfare schemes. The papers document the complex interrelationships among programs, and serve to demonstrate the extensive analysis which must precede real reform. A variety of "solutions" is possible, but objective analysis of what exists must come first. The problems defy simple solutions. The scope of analysis of and debate about the "public welfare problem" must reflect the \$100 billion scale on which these programs operate.

INTEGRATING SOCIAL INSURANCE AND NEED-BASED PROGRAMS

The major social insurance programs (social security, medicare, and unemployment insurance) and assistance programs (aid to families with dependent children, old age assistance, aid to the permanently and totally disabled, aid to the blind, and medicaid) are all maturing in terms of their coverage and level of benefits. As assistance benefits have been raised, the number of concurrent recipients of assistance and insurance programs has increased, and the notion that either type of program can be designed for specific, identifiable, and different population groups has become untenable. Concurrent receipt of or nominal eligibility for both types of programs has made compelling the need to analyze combined program impacts. Most troubling is the fact that some low- and moderate-income workers gain little or no income advantage from their social insurance coverage: some workers would be better off financially if they did not have to pay for or receive social security (or unemployment insurance) and if they had only assistance on which to rely. Quite simply, the programs are sometimes inequitable. This, of course, ignores the nonfinancial advantages which beneficiaries may find in social insurance as against assistance programs.⁵ While these program interrelationships pose serious issues now, they require far greater scrutiny in the context of a major welfare reform effort.

1. The Case of Social Security (Old Age Insurance) and Old Age Assistance

Michael K. Taussig considers how to coordinate these two programs so as to insure that a worker's (and his employer's) contribu-

⁵ The existence of these nonfinancial advantages has not been documented conclusively by surveys of recipients. In any case, they may largely disappear with respect to social security with the coming of the supplemental security income program.

tions buy him future benefits. In his paper, "The Social Security Retirement Program and Welfare Reform," Mr. Taussig, professor of economics at Rutgers University, notes the two functions which the old age insurance portion of social security serves now: partial replacement of earnings of retired individuals, and income support for presumably low-income people. The latter objective is pursued by means of weighting benefits to redistribute income to those retirees presumed to be the neediest. He argues that the distinction between these two functions has been blurred, and that this has resulted in inequities and inefficiencies.

Social security benefits are increased periodically, and special attention generally is paid to increasing the minimum and other low benefits to help the poor. This constitutes a "windfall" for many people who have retired under other retirement systems—such as civil service and military retirement—but who worked enough under the social security system to earn entitlement to a minimum benefit. Raising all old age insurance benefits is a highly inefficient way to help the needy since most of the expenditures on across-the-board increases do not go to the poor. This is because they can get welfare assistance for the aged, called old age assistance (OAA). When social security benefits have been increased, the OAA beneficiary's welfare payments generally have been adjusted downward by the same amount, leaving the dual beneficiary little or no better off. Other benefits based on need (veterans pensions, food stamps, public housing, medicaid) are also adjusted downward.

Old age assistance has operated inequitably in combination with social security, since those who have contributed nothing or only small amounts to the social security system can end up with benefits from old age assistance which can equal or exceed the social security benefits for which other workers have contributed substantial sums in social security payroll taxes. The level of old age assistance benefits exceeds what many people derive from social security. Indeed, old age assistance was designed to supplement social security. But the current manner of computing OAA means that social security coverage itself as well as most increases are worth little for those persons whose OAA payments are reduced dollar-for-dollar by social security. It also means that social security contributions have "bought" income that many retirees could have gotten anyway from the assistance program, assuming they meet other eligibility criteria such as the asset test.

Old age assistance and old age insurance are both uneasy mixtures of conflicting principles. Mr. Taussig presents the quandary: we press for better social insurance so that people do not have to apply for welfare, we skew the social security system to redistribute benefits to the presumably low-income beneficiary, and we raise the social security payroll tax rate and taxable wage base. But the welfare program in many instances is still more generous than social security (and carries with it medicaid coverage.)⁶ It could be said that moderate-income

⁶ Except in two States, old age assistance recipients also are entitled to valuable medicaid coverage which generally pays for drugs, hospitalization, and part B medicare premiums and deductibles. In contrast to the "welfare" provisions of old age insurance, however, there are no provisions in the OAA program for automatic cost-of-living increases and no automatic coverage of survivors and dependents.

workers paying high and regressive social security taxes to some extent are helping to finance fiscal relief to States whose public assistance costs are reduced when social security benefits are increased.

The new supplemental security income program, which will go into effect in January 1974, will mesh these two programs somewhat more smoothly. However, some of the same integration problems will continue.

Mr. Taussig argues that social security's earnings replacement function and the welfare income support function should be separated so that each program can fulfill its legitimate role more efficiently and so that in combination the programs are fairer. He prefers a dual system in which social security would be operated along stricter actuarial rules. The income support function would be handled by an explicit welfare program such as the supplemental security income program. Then, the rate at which social security income reduces old age assistance benefits could be set less than 100 percent. This would assure that no social security benefits are windfalls and it would channel money to the low- and moderate-income aged in an efficient manner.

Intermediate steps to integrate the two programs are also possible. If the nonfinancial advantages of redistributing income to the aged through social security outweigh efficiency arguments, the current social security system could be kept in its present form. Instead of offsetting social security benefits at a constant 100 percent rate, however, old age assistance could treat the "earned" and the redistributive elements of social security benefits differently. "Earned" benefit portions could reduce assistance benefits at a lesser rate than the redistributive portions. This breakdown of the social security benefit could not be done precisely, but reasonably satisfactory approximations could be developed. This approach to handling social security benefits could also be followed under the supplemental security income program which will replace the existing OAA program in January 1974.

2. The Case of Programs for the Unemployed

Similar problems are present in integrating unemployment insurance and need-based cash assistance programs. Raymond Munts raises some of these issues in "Programing Income Maintenance: The Place of Unemployment Insurance." Mr. Munts is professor, School of Social Work, and fellow, Institute for Research on Poverty, University of Wisconsin.

There are three major public programs assisting the able-bodied unemployed: Unemployment insurance (UI); general assistance programs funded and operated by State and local governments; and the unemployed father portion of AFDC, known as AFDC-UF.

Unemployment insurance is a group of programs operated by States under loose Federal control to provide wage replacement for some portion of the prior salary of qualifying unemployed workers. This program paid out \$6.4 billion to 8.7 million claimants in fiscal year 1972. Although coverage of workers was further extended in 1970, perhaps 11 million workers remain outside the UI system's coverage. The historical goal of replacing 50 percent of wages has not been met. A large proportion of beneficiaries receive the maximum benefits each

State allows, rather than the benefits a 50-percent replacement rate would dictate. UI benefits have fallen behind for a variety of reasons, among them being fears that higher benefits would discourage people from reentering employment.

Designers of welfare programs worry about work incentives too. But, as with programs for the aged, there are income-tested welfare programs for the unemployed which can be more generous both in benefits and in treatment of earnings.

The aid to families with dependent children-unemployed father (AFDC-UF) program, operated by 23 States and the District of Columbia with Federal matching, provides benefits on a par with AFDC to families headed by unemployed men who have had some recent, if minimal, connection with the labor force. These 24 jurisdictions include most of the large industrial States. They provide an average monthly benefit of \$258 to a family of four with no income, with a range from \$138 to \$350. Six of these States provide benefits for four-person families that are higher than the maximum UI benefit including dependents' allowances, and two other States provide nearly equal benefits. For larger family sizes, the number of States with AFDC-UF benefits higher than the UI maximum rises rapidly. And, of course, not everyone receives the maximum UI benefit.

We have then a situation similar to programs for the aged: welfare benefits can be more generous than UI, making some UI benefits look ungenerous for persons who can pass the welfare asset test. Unfortunately, men are prevented by Federal law from receiving UI and AFDC-UF at the same time (although women may receive UI and AFDC concurrently). So, men can qualify for the sometimes higher AFDC-UF payments if and only if they first exhaust their UI benefits. From the vantage point of some workers, their employers' UI contributions have not benefited them greatly. Indeed, some would be as well or better off financially under welfare both in terms of benefits and treatment of earnings, although they may prefer UI for social reasons.

In some States the equity situation with respect to unemployed men eligible for UI and those eligible for UF is not as severe because they have implemented programs with no Federal matching to help some portion of the persons excluded from Federal welfare programs. Sometimes full-time workers and unemployed, able-bodied persons may receive this supplementation. But these programs, known as general assistance, are usually low budget operations, sometimes dispensing rent and clothing vouchers instead of issuing cash, never reaching all who are eligible, sometimes limited to short periods of time only, usually having restrictive asset tests, and rarely treating earnings as generously as the AFDC-UF program.

3. The Case of Health Care Programs

Public medical care programs, like cash transfers, present problems of complicated interrelationships between their need-based and social insurance forms. These programs are considered by Theodore R. Marmor, associate professor at the University of Minnesota's School of Public Affairs. His paper is entitled, "Public Medical Programs and Cash Assistance: The Problems of Program Integration."

Mr. Marmor considers medicare and medicaid, the two major programs providing public financing for health care. He notes that, far from being a "poor program," medicaid, the program for the poor, is often more generous than the social insurance program of medicare. Medicaid is usually provided free to public assistance recipients for so long as they are entitled to even \$1 of cash benefits. Once recipients cross the eligibility ceiling for cash aid, however, all or a substantial part of medicaid benefits are lost as well.⁷ This, of course, serves to enhance the value of public assistance relative to social security. The sudden loss of medicaid for some persons who lose eligibility for public assistance when social security benefits are raised provides a most unfortunate demonstration of this.

4. A View of the General Problem

The social insurance programs clearly require closer coordination with their counterpart need-based programs and coordination with any welfare reform plan as well. More specifically, basic decisions must be made regarding what functions we want each type of program to accomplish. Cash social insurance benefit levels are unlikely to ever completely outstrip those provided under need-based programs. One approach would be to count social insurance benefits at a rate less than \$1 in computing eligibility for assistance programs, just as earnings are generally counted at less than a \$1 rate under assistance programs in order to keep work profitable. This would stand in sharp contrast to the current practice of reducing assistance payments \$1 for each dollar of social insurance payments.

There are two problems to be resolved before this approach is workable, however. Asset tests under assistance programs would have to be liberalized if some social insurance beneficiaries—having low income but moderate assets—were not to be excluded from assistance supplementation. Instead of a flat (and very low) dollar ceiling as is the case now, some percentage return on asset value could be imputed as income which would reduce assistance payments. The new supplemental security income (SSI) assistance program for the aged, blind, and disabled, for example, contains a low and arbitrary asset value ceiling.⁸ This provision could serve to keep some social security beneficiaries from receiving supplementation. The stringent asset test will confront people with a difficult choice: they can either decline SSI benefits and live on less in order to hold their meager bank savings for emergency use; or, they can spend enough of their savings to be eligible for SSI and live better now but have less of a cushion for emergency needs.

The second problem requiring solution would be to either redirect social insurance programs along stricter insurance lines or to treat the "earned" and the redistributive aspects of the insurance benefits differently under assistance programs. This problem was noted earlier in respect to social security, which has large "welfare" elements in its

⁷ In some States former public assistance recipients or persons who would be eligible for public assistance if their incomes were somewhat lower can receive free health care if they incur medical expenses which reduce their incomes to an amount no higher than 133 percent of the public assistance eligibility standards.

⁸ Nevertheless, the SSI asset limit is higher than most current State OAA asset ceilings.

benefit schedule. So long as the social insurances perform income support functions for low-income persons in addition to wage replacement, however, it will be inefficient and very costly to treat these benefits as ordinary earnings in computing assistance payments.

Especially with respect to unemployment insurance, however, maintaining the value of UI coverage by counting UI benefits at a rate less than 100 percent under programs such as the family assistance plan raises work incentive questions. This is because for many persons the combined benefits can amount to high percentages of former wages and because the combined benefit-loss rates can become very high. These problems are discussed in the following section.

WORK INCENTIVES

The way in which public welfare benefits are reduced (or increased) as income rises (or falls) has a direct bearing on how profitable work is and, therefore, on the work incentives which programs offer recipients. Work incentive issues are central to all the papers in this volume.

1. The Case of Programs for the Unemployed

Since the 1967 amendments to the Social Security Act, public assistance policymakers have rejected the notion that benefits for employable persons should be reduced \$1 for each dollar of earnings.⁹ Yet, while it may be less objectionable for time-limited benefits, this is the structure of unemployment insurance. Most State UI programs penalize part-time earnings. Claimants often face benefit-loss rates of 100 percent and higher over large ranges of income; that is, a dollar of income earned is a dollar of unemployment compensation lost. Thus, claimants gain little or nothing for their interim work efforts.¹⁰ For example, Worker Jones may be entitled to \$65 a week in unemployment insurance. He or she may earn a small amount—say, \$5 per week—without losing any benefits. But, if Worker Jones takes a part-time job earning \$45 a week, benefits will be reduced by \$40, leaving a net *loss* after social security taxes, carfare, and other work expenses are met.

The lack of structural work incentives is offset to some extent by the limitation on the duration of UI benefits and by the UI work search requirement, but little is known on an objective basis about how rigorously the work search requirements are monitored and enforced.

Pressures to broaden UI coverage, raise the percentage of lost wages replaced, require dependents' allowances, and lengthen the duration of benefits have been raised by the existence of uncovered workers and the relatively low UI benefits. Mr. Munts presents the case for such reforms but notes that compromises among them are necessary if work incentives are to be maintained.

UI can be restructured to allow recipients to keep, say, 20 to 30 cents of their unemployment insurance benefit dollar for each dollar

⁹ These amendments reduced the marginal benefit-loss rate in the aid to families with dependent children program from 100 to 67 percent.

¹⁰ A study done some years ago by Mr. Munts suggested that UI claimants in Wisconsin were aware of the high benefit-loss rates and tailored their earnings while collecting UI to maximize the combination of UI and earnings. This study is entitled, "Partial Benefit Schedules in Unemployment Insurance: Their Effect on Work Incentive," and is found in *The Journal of Human Resources*, vol. V, No. 2 (1970).

of earnings. But, if the benefits were increased to a higher percentage of former wages as well, the combination of benefits and earnings could be higher than or very close to previous earnings. This would, of course, be unfair to the steady worker. Moreover, it would result in the bizarre situation of employers financing a wage subsidy scheme for their unemployed workers but not for those currently at work.

UI benefits are not taxable, and there are little or no work expenses incurred in receiving them. Thus, to increase UI benefits to, say, 70 percent of previous gross wages may mean that it is as profitable to be unemployed as it is to work. This is especially true when employers provide supplementary unemployment benefits and the unemployed worker collects food stamps or other public benefits. Again, since UI benefits are time-limited, this might not be objectionable. But it would require compromise with proposals to lengthen permanently the period of time over which regular UI benefits may be collected as well as with proposals to treat part-time earnings more generously. Just as with negative income tax proposals, there is a conflict between the objectives of providing adequate benefits and building in work incentives.

Assistance programs for the unemployed receive mixed marks in terms of work incentives. AFDC-UF benefits are limited to families whose male head works 100 hours a month or less. For persons who qualify, the earnings disregard (work incentive) provisions of AFDC apply: that is, before computing benefits people may deduct from their monthly earnings \$30 and one-third of the remainder plus all expenses reasonably related to work. This stands in contrast to the general practice of reducing UI benefits \$1 for each dollar earned. Thus, so long as the hours of work do not exceed 100 hours per month, AFDC-UF supplementation (and food and medicaid benefits in most instances) may be received at remarkably high earnings levels—up to \$5,000, \$6,000, and \$7,000 is possible. (Of course, full-time workers earning up to these levels are not eligible for AFDC-UF supplementation, and hence can be at a distinct financial disadvantage. That is to say, low-wage, full-time workers can have lower incomes than people working at the same or higher wage rate but for fewer hours.) But, when hours of work exceed 100 per month, the worker loses his UF benefits and stands to lose considerable income as well.

State-run general assistance programs sometimes cover able-bodied men (whether they are employed or unemployed), but they usually have very stiff benefit-loss rates as earnings rise—often 100 percent. These restrictions and high benefit-loss rates are a matter of economic necessity. States and localities cannot afford to run noncategorical,¹¹ high-level, income supplement programs which reach into quite dense sections of the income distribution.

The two assistance programs and the major social insurance program for the unemployed are either inequitable, or have severe work disincentive features, or both. Yet the large client population consists of prime-age working people about whom we should be especially concerned about when it comes to work incentives.

Any proposal similar to the family assistance plan (FAP) would provide greater rationality with respect to work incentives than

¹¹ "Noncategorical" refers to programs which are available universally to persons meeting eligibility criteria such as need and not just to specific groups or categories of the population such as the aged or female-headed families.

current assistance programs. Yet the features of UI have implications for welfare reform, as Mr. Munts notes. The combination of current UI and FAP presents difficult problems of program integration if UI benefits do not offset FAP payments on a dollar-for-dollar basis. If FAP benefits are reduced by less than \$1 for each UI dollar, the combination of UI and FAP can reach a high percentage of former wages—higher than has been thought desirable in UI alone. Moreover, regardless of whether UI is changed to provide more generous treatment of earnings itself, the combination of UI and FAP benefits can raise benefit-loss rates as earnings rise to levels that welfare reformers find undesirable. Thus, there is a conflict between maintaining some residual value of UI coverage (which equity would seem to require), and maintaining work incentives. This conflict does not have an easy resolution.

2. The Case of Medical Care

The structure of medicaid has work disincentive or “notch” problems over certain income ranges. Free medical care is provided on an all-or-nothing basis, rather than scaled to income, to public assistance recipients in about half the States. In the other States, former cash payment recipients remain eligible for subsidized health care on a graduated basis with requirements that they first spend “excess” income on health care. While the work disincentive aspects of the notch is not as troublesome for the aged, this structure has unfortunate effects on them when benefits suddenly are taken away.

Medicaid thus stands in contrast to the food stamp program which reduces the bonus value of the stamps by about 25 cents for each additional dollar of income. Food stamp benefits decline quite smoothly. Medicaid or a more general medical plan could be provided in this way. For example, the equivalent of a \$700 health insurance package could be provided free to low-income persons with the requirement that they contribute to the cost of their care as their income situation improves. This requirement, of course, would set up a benefit-loss rate for medicaid similar to the food stamp benefit-loss rate. If this bite from added earnings were added to benefit losses under cash income supplement programs, food programs, housing programs, child care programs, and Federal income and social security taxes, the resulting cumulative gain from work could be small indeed or could even become a loss. Providing free health care to everyone avoids this problem for low-income people. Financing these benefits through general revenues or a special payroll tax would result in higher taxes for middle- and upper-income groups, however, although these higher taxes would be offset somewhat by savings of most current personal expenditures on health insurance and health care.

EQUITY IN BENEFIT DISTRIBUTION: THE PROBLEM OF GENEROUS BENEFITS FOR SOME GROUPS WHILE OTHERS ARE EXCLUDED ALTOGETHER

With few exceptions, public welfare programs deliver benefits to only a fraction of the population which is either nominally eligible or in need of the benefits or services. This results from several factors: failure to fund programs at required levels; conscious and formal exclusion of some groups on the grounds that they are or ought to be

To focus the work of the authors, it was necessary to provide them with a common structure within which their analyses could proceed. In addition to discussing problems of coordinating the current group of programs, authors were asked to consider program integration issues arising from institution of three different welfare reform plans. These plans do not reflect the policy preferences of the Subcommittee on Fiscal Policy or its staff. They are, rather, examples drawn from a considerable number of variants of three basic welfare structures: The negative income tax; public employment and wage subsidies; and demogrants. The first two of these basic reform approaches had the advantage for our purpose of having been worked out in some detail as part of the legislative process.

H.R. 1, as passed by the House of Representatives in June of 1971, was chosen as the negative income tax variant, in part because at the time several of these papers were begun it seemed possible that this bill would be enacted.¹² It would have replaced the State-run aid to families with dependent children (AFDC) program with a basic Federal negative income tax-type cash supplement program for all families with children—without regard to the sex of the family head—and an optional State supplemental program. It would have paid \$2,400 annually for a family of four without any other income, and greater and lesser amounts for larger and smaller families. Each dollar of earnings above \$720 a year would have reduced the benefits by 67 cents, so benefits would have declined to zero at \$4,320 of earnings. The food stamp program would have been eliminated for cash recipients.

The State administered programs of assistance to the aged, blind, and disabled would have been replaced by a single federally administered program. Individual recipients would initially have been guaranteed \$130 monthly and couples \$195. As in the family program, States were free to supplement these basic amounts at levels of their choice.¹³

These and other provisions of the bill are contained in the *Report of the Committee on Ways and Means on H.R. 1*, House Report No. 92-231, May 26, 1971.

The welfare reform proposals of the Senate Finance Committee were selected as the second basic welfare reform alternative for authors to consider. These proposals are delineated in *Summary of the Principal Provisions of H.R. 1 as Determined by the Committee on Finance*, Senate Finance Committee Print, June 13, 1972.

This bill would have given more regulatory power over welfare to the States and would have concentrated Federal efforts on getting people to work through guaranteed jobs and child care, and subsidizing wages for persons working at low wage rates. No welfare aid would have been extended to employable persons who did not work. The committee bill provided three basic types of benefit to heads of families other than those, such as women with children under age 6, who would have continued to be eligible for AFDC:

¹² Many of the provisions of this bill, especially those relating to family welfare aid, were not part of the H.R. 1 bill which was passed by the Congress in October 1972.

¹³ These provisions relating to adults were passed in the final version of H.R. 1 in 1972.

(1) A guaranteed job opportunity with a newly established Work Administration paying \$1.50 per hour for 32 hours for a maximum weekly wage of \$48.

(2) A wage supplement for persons employed at less than \$2 per hour (but at least \$1.50 per hour) equal to three-quarters of the difference between the actual wage paid and \$2 per hour.

(3) A work bonus equal to 10 percent of wages covered under social security up to a maximum bonus of \$400, with reductions in the bonus as the husband's and wife's covered wages rise above \$4,000.

These benefits would not have been scaled to family size, although AFDC benefits for women having children under age 6 would have been so adjusted.

Provisions for the aged, blind, and disabled were quite similar to those passed by the House.

The third alternative was a universal demogrant plan combined with changes in the Federal personal income tax. Flat payments to everyone in the population would be substituted both for Federal participation in current family and adult public assistance programs and for personal exemptions and deductions under the income tax. The assumption is that instead of being simply refundable income tax credits to offset tax liabilities, these demograts could also take the form of periodic (monthly, for example), grants to those with low incomes. This would equalize the value of the personal exemptions and deductions under the income tax.

One version of such a plan was described by Earl Rolph in "The Case for a Negative Income Tax Device."¹⁴ Mr. Rolph would adopt a proportionate tax on nearly all income except the flat grant. For example, if grants were set at \$800 for adults and \$400 for children, a family of four with no income would receive \$2,400 a year. If the proportionate income tax rate were set at 33 percent, a family with \$7,200 of earnings would neither pay taxes nor receive a grant on a net basis. Its tax liabilities of \$2,400 (one-third of \$7,200) would be offset by its grants of \$2,400.

¹⁴ *Industrial Relations*, VI, No. 2 (February 1967), pp. 155-165.

THE SOCIAL SECURITY RETIREMENT PROGRAM AND WELFARE REFORM

By MICHAEL K. TAUSSIG*

I. INTRODUCTION AND SUMMARY

This paper surveys the major issues involved in integrating a social security retirement program into an expanded income maintenance system in the United States. The scope of the paper is limited mainly to income maintenance issues related to retirement and the aged population. Other income maintenance programs, including the social security programs directed at nonaged survivors, the disabled, and the medically needy will not be discussed at all or will be treated only very briefly. Thus, the paper attempts to focus sharply on the old-age insurance (OAI) component of the total old-age, survivors, disability, and hospital insurance (OASDHI) social security package. The separation of OAI from general social security involves a high degree of abstraction but it has great practical advantages for the kind of analysis attempted in this paper. Following the usual convention, reference in the paper to the "aged" will denote all individuals aged 65 and over, although as later discussion in the paper will note, the exact boundary between the aged and the nonaged is somewhat blurred and is an important variable in the economics of social security. The basic question for analysis, then, is how OAI can best be integrated into one of a number of possible general income-maintenance systems.

Social security in the United States is difficult to disentangle from welfare because in its present form it serves two related but distinct functions, one of which overlaps with the basic function of welfare. OAI, for example, partially replaces the earnings of individuals when they retire, whatever their income level, but at the same time it heavily weights its benefit formula to redistribute income among the aged to those retirees presumed to be most needy. The first of these functions may be called *earnings replacement* and the second *income support*.¹ The income support function of OAI inevitably makes it overlap with existing welfare programs that share the OAI income support function by providing cash or in-kind income

*The author is professor of economics, Rutgers College, Rutgers University. He is grateful to John J. Carroll, Irene Cox, John Snee, Thomas G. Staples, and Alair Townsend for their helpful criticisms of earlier drafts of the paper. None of these individuals necessarily concurs with the views expressed in the paper, however, and the author is solely responsible for all factual errors that remain. This paper was prepared for the Conference on Integrating Income Maintenance Programs held at the Institute for Research on Poverty in July 1972. The conference was sponsored jointly by the Institute for Research on Poverty and the Subcommittee on Fiscal Policy of the Joint Economic Committee.

¹ In more traditional social insurance terminology, the earnings replacement function is identified with the principle of *individual equity*, while the income support function is identified with the principle of *social adequacy*.

for the aged poor. Once the distinction between the two functions of OAI is established, the issue immediately arises as to which of the two functions is more important for social policy. The author of this paper believes that both functions are valid and that both should be strengthened in any income maintenance reform. The allocation of resources between the two programs and alternative programs should be, in my view, a matter for explicit, informed political choice and any scheme for integrating OAI into a new, reformed income maintenance system should maximize the possibilities for intelligent social decisions about these programs. Readers who differ with the author on the appropriate functions of income maintenance for the aged can readily reinterpret the discussion in the paper according to their own views.

The discussion in the paper considers only two major alternative reforms of the present income maintenance system to be relevant to OAI and the aged: (1) A negative income tax type of program such as the plan proposed by the President's Commission on Income Maintenance Programs;² and (2) a universal demogrant, such as the one described in Rolph's credit income tax proposal.³ A more or less mandatory public employment program as an alternative to either a negative income tax or a demogrant, such as the one voted in 1972 by the Senate Finance Committee,⁴ is, in my judgment, almost completely irrelevant to my subject in this paper. The Senate Finance Committee did not contemplate making public employment a prerequisite for the payment of cash benefits to the aged and it seems safe to assume that extension of the mandatory public employment idea to the aged population will never gain significant political support. If mandatory public employment programs ever do go into effect for the needy, nonaged population, they will relate to OAI only incidentally in that they will undoubtedly involve some payment related to either OAI or Federal civil service retirement, and thus will marginally broaden the coverage of public retirement programs in the future. But aside from this minor connection, we can ignore the Senate Finance Committee's public employment program proposals for the balance of the paper and concentrate on the negative income tax and demogrant alternatives for income maintenance reform. The general principles involved in integrating OAI into these two types of programs could be extended easily to apply to any other general, income-conditioned alternative approaches to income maintenance reform.

Within the scope of the paper, as delimited above, the discussion that follows covers the following topics: Section II considers the relationship between OAI and welfare in historical perspective and describes the present situation. It also surveys the general issues of costs, benefit adequacy, and economic incentives relevant to the integration of OAI into any income maintenance system. The main

² *Poverty Amid Plenty: The American Paradox*. The report of the President's Commission on Income Maintenance Programs. Washington: U.S. Government Printing Office, 1969.

³ Earl R. Rolph, "The Case for a Negative Income Tax Device," *Industrial Relations*, VI, No. 2 (February 1967).

⁴ Committee on Finance, U.S. Senate, *Social Security and Welfare Reform. Summary of the Principal Provisions of H.R. 1 as Determined by the Committee on Finance*. Washington, D.C.: U.S. Government Printing Office, 1972.

conclusion of this section of the paper is that the integration of OAI into a reformed income maintenance system must preserve incentives to work and to save for retirement in order to prevent a worsening of the relative income status of the aged. Section III then considers the major program integration problems of the present income maintenance system for the aged. The present system is based on the relationship between OAI and the supplementary security income program, SSI, enacted in 1972 and effective as of January 1, 1974. (SSI at that date will replace the State administered old age assistance program, OAA, as the basic public welfare program for the aged.) Integration problems in the present system arise because of the sharing of the income-support function for the aged between the OAI and SSI programs. Preservation of the system in anything like its present state is shown to require unacceptably low benefits under SSI relative to minimum OAI benefits. If benefits under SSI are increased to the levels required on humanitarian grounds, horizontal inequities⁵ that already exist in the system would become intolerable. This unpleasant fact leads to consideration of two quite different approaches to reform of the system.

The first of these alternatives, sketched in section IV of the paper, would strip OAI of its income-support function and transform it into a pure earnings-replacement program while either a negative income tax or a demogrant program would take over all income support responsibilities for the aged and the nonaged alike. The second alternative, discussed in section V of the paper, would rationalize the income maintenance system for the aged within a single program by blanketing in all the aged within an expanded OAI program while eliminating SSI for the aged and, ideally, all other public retirement programs as well (except as private-pension type supplements to the basic public retirement program). This kind of *unitary* income system for the aged would thus separate out the aged from the nonaged for income support purposes in contrast to the first alternative, the *dual* system, which would incorporate the aged with the nonaged under either a universal negative income tax or demogrant for basic income support while dealing with earnings replacement for aged retirees through a restructured OAI program of more limited scope.

The choice between a dual system and a unitary system of income maintenance for the aged depends partly on technical issues of program integration which impinge on incentives to work and save and involve problems of achieving equity among the aged. These issues are all discussed in some detail in the main body of the paper. On these grounds, the dual system appears to have a clear edge, with the proviso that this conclusion depends on the exact details of two most complex hypothetical systems. Of course, Congress does not have to make the kind of stark choice between one system or the other implied in the above discussion; it can instead choose a system incorporating elements of both systems. But the two alternatives are nonetheless useful in posing a basic policy choice for society in its approach

⁵ Horizontal inequity means unequal treatment of persons who are equals with respect to income and a few other characteristics related to consumption needs, such as size of the family unit. With respect to the aged, cases of horizontal inequity arise when elderly persons in identical circumstances are subject to different tax burdens or are not eligible for the same total benefits from various income maintenance programs.

to income maintenance for the aged. The choice involves an inescapable judgment about whether the aged should be separated from the non-aged for income support purposes and be given special, relatively generous treatment. Congress has obviously felt in the past that the aged do merit special treatment and therefore is likely to opt for what is called in this paper a unitary system or something very much like it. Those who feel as I do that it is unwise social policy to create special categories for income maintenance programs are likely to opt instead for something like the dual system. The choice between the two systems thus involves matters of great social consequence as well as technical details of program integration.

II. THE PRESENT INCOME MAINTENANCE SYSTEM FOR THE AGED: AN OVERVIEW

The Historical Development of OAI and OAA

The present income maintenance system for the aged in the United States dates back to the Social Security Act of 1935 which created both OAI and OAA. The intent of Congress in the initial social security and welfare arrangement seems to have been the creation of two separate, complementary income maintenance programs for the aged. OAI was intended to be an earnings replacement program with benefits tied closely to accumulated lifetime payments into an OAI trust fund while OAA was supposed to be an income support program for those aged families or individuals whose own resources, including OAI benefits, were not sufficient to maintain some socially determined minimum standard of living. Thus the world envisioned by the drafters of the 1935 legislation appears to have been closely comparable in broad outline to the dual income maintenance model to be discussed in section IV of this paper. Congress apparently hoped in 1935 that OAA would gradually dwindle to a very small residual program once the OAI system matured and most aged, retired individuals became eligible for substantial OAI benefits in addition to their other sources of income.

These original arrangements were fundamentally altered, however, by the first amendments to the Social Security Act in 1939.⁶ The 1939 amendments considerably altered the original income maintenance system for the aged and created a new basic framework that has persisted with only modest changes down to the present time. In brief, the 1939 amendments introduced important elements of income support (social adequacy) into OAI, abandoning its original relatively strict earnings replacement (individual equity) orientation. The basic principle of tying benefits to accumulated lifetime social security taxes for each individual was abandoned in favor of basing benefit amounts on the average covered earnings over a minimum time period. Relatively large benefit payments thus could be paid sooner than under the 1935 legislation. At the same time, the system was put on a virtual cash or pay-as-you-go basis and the plan to accumulate a large OAI

⁶ For further details on the development of social security in the United States, and for references, see Joseph A. Pechman, Henry J. Aaron, and Michael K. Taussig, *Social Security: Perspectives for Reform*. Washington: The Brookings Institution, 1968.

trust fund was effectively scrapped. Other aspects of the 1939 amendments and subsequent social security amendments since 1939 have for the most part reinforced the basic decision to give additional weight to the income support function of OAI at the expense of its earnings replacement function. To a large degree, the actions embodied in the 1939 amendments were based on the stark reality that millions of aged people were manifestly needy and that the OAA program could not meet their needs because of the unwillingness and inability of the States to give OAA more than minimum financial support. Given this situation, the decision to make available the large OAI revenues for benefits as soon as possible was the common sense humanitarian response, and it was given further rationalization by academicians with arguments about the appropriateness of "social adequacy" in social insurance programs.

In addition, Keynesian economists could observe that the accumulation of OAI taxes in the OAI trust fund in the late 1930's served no useful function in a period when national savings already exceeded investment at a full employment level of output. Since the trust fund accumulations could not be converted into real investment and by no stretch of the imagination could be linked with a faster rate of economic growth, there was no sound macroeconomic reason why the OAI revenues should not have been used to support the aged, even granted adherence to the principle of strict earnings replacement in the long run.

Thus, for understandable historical reasons, this country now has an OAI social "insurance" program that bears the major cash income support burden for the aged, while OAA (and, after 1973, SSI) picks up a residual category of the aged for minimum income support. Railroad retirement (closely tied to OAI), veterans' pensions, civil service and military retirement programs, private pensions, and a very small amount of individual and group charity sources of income all play some role in the total system. Public in-kind programs such as medicare and medicaid supplement these cash income programs. An income maintenance system for the aged that was largely a response to an urgent but short-run need more than three decades ago has persisted with very little change until this day with the powerful support of vested interests and social inertia. OAI is now virtually a mature system in most respects. Coverage of workers, with the important exception of Government employees, is approaching the maximum limit and most individuals approaching age 65 are now eligible for OAI benefits. Therefore, it is timely to reexamine the question of the optimum income maintenance system for the aged under conditions that approximate the theorist's long-run equilibrium.

The Current Dimensions of OAI and OAA

Some recent data may be helpful in establishing the dimensions of the current income maintenance system for the aged. The number of aged retired worker beneficiaries in OAI current-payment status in September 1972, was 13.0 million and the number of aged dependents and survivors was 5.1 million.⁷ With the addition of 426,000

⁷ *Social Security Bulletin*, vol. 36, No. 1 (January 1973), table M-14, p. 49. Aged survivors cannot be exactly allocated between OAI and the survivors' program of the total social security program.

individuals receiving special transitional age 72 and over OAI benefits, the total number of aged individuals receiving OAI (or OASI) benefits came to 18.5 million. If we could simply add to that number the approximately 2 million individuals receiving OAA benefits and the well over a million aged beneficiaries of railroad retirement programs, Federal civil service retirement programs and veterans' retirement and disability programs, the total number of aged beneficiaries of public retirement programs would exceed the approximate total of 20.9 million aged individuals in the United States in 1972. The fact that many persons benefit from more than one such program precludes such a simple addition, however, and many aged individuals received no public benefits either because they earned enough to be made ineligible for OAI benefits by its earnings test, or were not covered by OAI and had sufficient income from other sources to be ineligible for OAA benefits, or because they did not qualify for OAA benefits under the conditions established by State and local governments. The enactment of SSI will presumably eliminate the last of these circumstances and broaden the coverage of public income maintenance programs to all the needy aged after 1973. In addition to the above data, which refer only to individuals aged 65 and over, some 2.6 million retired or disabled workers or dependents or survivors of workers aged 62 to 64 were receiving OASDI benefits in September 1972.

As evidenced by the numbers cited above, the OAI program now dominates the OAA program but this has not always been true. In 1940, only 1.6 percent of the age 65 and over population was receiving OASDHI benefits as compared to 22.5 percent of this same population receiving OAA benefits. By 1950, the number receiving OASDHI benefits had grown to 20.5 percent, while the number receiving OAA benefits remained quite stable at 22.1 percent. By 1960, OASDHI benefits were going to 63.8 percent of the aged population as compared to only 13.7 percent receiving OAA benefits. As of 1971, the same percentages were 85.3 percent for OASDHI and only 9.6 percent for OAA. In 1971, 6.2 percent of the aged population were receiving both OASDHI and OAA benefits.⁸ Thus, the maturing of the OAI program has been matched by a corresponding withering away of the OAA program. After 1973, the SSI program may raise the percentage of the aged on welfare, at least for a short time, both because it will provide a national minimum cash income higher than the current maximum OAA benefits amounts available in some States and because it is intended to be comprehensive in its coverage of all the needy aged.

Total OASI benefits paid in 1971 amounted to \$33.4 billion, a figure which gives the approximate dimensions of the OAI program, although it includes payments to nonaged survivors.⁹ (On the other hand, it does not include hospital insurance (HI) benefits available to the aged.)

Total OASI benefits have risen very sharply in the past and are expected to continue going up at almost the same rate in the near

⁸ *Social Security Bulletin*, vol. 35, No. 12 (December 1972), table Q-4, p. 73.

⁹ Committee on Finance, U.S. Senate, and Committee on Ways and Means, U.S. House of Representatives. *Summary of Social Security Amendments of 1972. Public Law 92-603 (H.R. 1)*. Washington: U.S. Government Printing Office, 1972, table 4, pp. 34-35.

future. Total OASI benefit payments were only \$16.7 billion as recently as 1965 and are projected to rise to \$61.3 billion by 1977.¹⁰ In contrast, total OAA benefits have amounted to only about \$2 billion a year recently, and the cost of SSI for the aged is projected at only \$3.5 billion in 1974.¹¹ Some further points should be made about these numbers. While the total cost of public income maintenance programs for the aged is very large and is going up rapidly, benefit levels under these programs do not provide incomes that allow the aged to live at the consumption standards of the nonaged in the absence of other income sources. The minimum OAI benefit amounts even after the 1972 social security amendments are only \$84.50 for a retired worker and \$126.80 for a retired worker and his wife. SSI cash benefits for the aged will be only \$130 for an individual or \$195 for a couple in 1974. Thus, despite the huge outlays for public income maintenance programs for the aged that must be financed by taxes on the nonaged, income support for the aged does not yet guarantee them decent standards of living.

Economic Aspects of Income Maintenance for the Aged

The preceding section attempted to place the current income maintenance system for the aged in historical and statistical perspective. Now let us turn to a brief, very general discussion of some economic relationships relevant to any reform or expansion of the system.

The ultimate goal of an income maintenance system for the aged is, of course, to maximize their well-being, subject to the constraints of attaining other urgent social objectives. The present system is far from reaching this goal. The economic status of the aged has been described quite fully in several recent studies.¹² The major conclusion of these studies is that the aged lag far behind the nonaged in average levels of economic welfare. Adjustments of raw income data to take account of differences between the aged and the nonaged in such factors as asset holdings and size of the family unit qualify this conclusion somewhat but do not alter its basic message. Our society has not yet proved willing or able to provide a sufficient income substitute for earnings for the majority of the aged who are retired. The aged who are able and willing to continue to work are relatively young and well off while the very aged who cannot work are in the worst financial straits. Although only about one-fourth of all aged males and less than one-tenth of all aged females were still in the labor force, data from the 1968 Survey of the Aged indicate that earnings nonetheless accounted for 30 percent of the total income of all the aged in 1967.¹³ Income from assets accounted for another 25 percent of the total. In contrast, social security benefits, the major income source

¹⁰ Ibid.

¹¹ Ibid., table 11, p. 43.

¹² See, for example Lenore E. Bixby, "Income of People Aged 65 and Older: Overview from 1968 Survey of the Aged," *Social Security Bulletin*, vol. 33, No. 4 (April 1970); Robinson Hollister, "Income Maintenance Reform Issues With Respect to the Aged," in Larry L. Orr, Robinson G. Hollister and Myron J. Lefcowitz, editors, *Income Maintenance: Interdisciplinary Approaches to Research*. Chicago: Markham Publishing Co., 1971, and Pechman, Aaron and Taussig, op. cit., ch. II.

¹³ See Bixby, op. cit., p. 14.

for most of the aged, amounted to only 26 percent of the total in the same year. This data source leaves no doubt that economic well-offness among the aged is highly correlated with the presence of earnings and income from assets in a household's total income sources.

These figures give strong support to arguments that economic incentives to work and to save for retirement must be preserved in any future development of the income maintenance system for the aged, even in our affluent society. If all the aged retire from work and if nonaged families do not save for retirement, public retirement programs can support the aged even at very low standards of living only at enormous cost. To provide as little as \$3,000 per capita support for all the 20 plus million aged today would mean an income maintenance bill for the aged alone of over \$60 billion. The tax rates required on the incomes of the nonaged to foot this bill are probably not politically feasible but, if effected, could have a serious impact on the funding of Government social welfare programs for the nonaged.

A formal statement of the relationship between average OAI benefit levels, B , and the average OAI tax rate on earnings, t , may help to illustrate some basic economic facts of life concerning the costs of income maintenance for the aged. If we define W as the mean earnings of workers covered by OAI, N_W as the number of such workers and N_B as the number of OAI retired worker beneficiaries, then we can write the following as a condition of equality between OAI taxes and benefits in a pay-as-you-go retirement system:

$$(1) \quad tN_W W = N_B B$$

Solving for t , we obtain¹⁴

$$(2) \quad t = \frac{N_B}{N_W} \times \frac{B}{W}$$

Equation (2) tells us that the tax rate on earnings in a pay-as-you-go system varies directly with the ratio of retired beneficiaries to active workers and with the ratio of average benefits to average earnings. The latter ratio reflects a clear choice in redistributing incomes between the nonaged and the aged. The former ratio reflects both demographic and economic factors. The basic demographic factor is, of course, the relative size of the aged population, which depends primarily on fertility and mortality experience. The relative size of the aged population in this country is relatively insensitive to large variations in future demographic developments through the end of this century and OAI costs are not expected to change much for this reason for the next three or four decades. In 1970, the aged population of 20,156,000 was 9.8 percent of the total population. Estimates of the relative size of the aged population in the year 2000 vary only between 9.6 percent (series C projection) and 11.5 percent (series F projection) with the former estimate based on quite high, and the latter estimate on quite low, assumptions about future fertility experience.¹⁵ Therefore,

¹⁴ Note that t in equation (2) is the effective average tax rate on all covered earnings. The maximum covered earnings level for OAI taxes determines the statutory tax rate and the distribution of the tax burden among workers at different earnings levels.

¹⁵ Bureau of the Census, "Projections of the Population of the United States, by Age and Sex: 1972 to 2020," *Current Population Reports*, series P-25, No. 493. Washington: U.S. Government Printing Office. 1972.

income maintenance costs for the aged are unlikely to be greatly affected for some time by this particular variable. After the turn of the century, however, demographic factors are anticipated to raise the costs of OAI sharply.¹⁶

Given demographic factors, the ratio of retired beneficiaries to workers in OAI and the tax cost per worker to support the program depends on economic influences. In particular, it depends on the choices aging workers make regarding the timing and extent of retirement. If all individuals aged 65 and over retire in the future, OAI costs will rise by between 5 and 10 percent.¹⁷ And if all individuals aged 62 and over should also retire, OAI costs would go up by an additional 5 to 10 percent. Either of these very costly developments would seem to be a real possibility if we simply extrapolate into the future past trends in the labor force participation of the aged. The latter development is probably critically related to the definition of the retirement age in OAI. Pressures have been and continue to be strong to redefine the age of eligibility for full OAI benefits as age 62, or even age 60, from the present age 65. On the other hand, it may be poor economics to forecast higher retirement rates for the aged in the future on the basis of past experience. In the future, the aging worker will more and more hold jobs that require mental rather than physical skills and that are relatively pleasurable compared to complete retirement. Public policies that preserve work incentives for the aged thus could help in reversing the trend to earlier retirement and could be a significant factor in improving the relative economic status of all the aged—retirees and workers alike.

III. THE PRESENT INCOME MAINTENANCE SYSTEM FOR THE AGED: THE NEED FOR REFORM

The income maintenance system for the aged as of January 1, 1974, will consist primarily of the OAI and SSI programs. The first candidate for the system of tomorrow is surely the system of today, made up of these same two programs with their basic features intact, and with legislative tinkering only at the margins. Continuation of the present system would seem on first consideration to meet the test of political feasibility and certainly would minimize transitional difficulties. The present system has long had its critics, but much of the criticism has come from opposite ends of the political spectrum and has been mostly offsetting. Marginal changes in the system as, for example, the provision of special OAI benefits for uncovered individuals aged 72 and over or the progressive relaxation of the OAI earnings test, have patched up its most obvious deficiencies in the past. Furthermore, the enactment of SSI in 1972 in H.R. 1 apparently has removed most of the serious objections to the old State-administered categorical welfare programs, including OAA. Paradoxically, however, the reforms of the OAA program incorporated in SSI raise questions about the rationality

¹⁶ See the appendix on actuarial methodology in *1972 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*. Washington: U.S. Government Printing Office, 1972, pp. 35-46.

¹⁷ The estimates in the text are based on information generously provided to the author by the Office of the Actuary of the Social Security Administration. They are subject to errors of interpretation by the author.

of the whole income maintenance system for the aged with even more insistence than before 1972. Two closely related problems inevitably plague the present system: (1) It is full of severe horizontal inequities in its treatment of the low-income aged; and (2) its basic structure is inconsistent with the underlying ideological rationale for the OAI social insurance program.

Before elaborating on these points, it may be useful to consider in detail how the SSI and OAI programs will interact after 1973. As noted above, the new SSI program will provide uniform national minimum income guarantees to all the aged. In so doing, it will tend to remove the most severe horizontal inequities across States that existed in the old OAA program and will relieve the aged poor of the vagaries of the various State welfare regulations defining eligibility. The income guarantees scheduled under SSI are relatively generous by the standards of the past—at least in the low welfare benefit States—\$130 a month for an aged individual and \$195 a month for an aged couple. These amounts compare favorably with the minimum OAI benefit of \$84.50 a month for a single retired worker and \$126.80 for a retired worker and his (her) dependent spouse. Further, they are virtually equal to the special minimum OAI benefits of \$127.50 for a retired worker and \$191.30 for a retired worker and his (her) dependent spouse with 25 years of covered employment. Thus, the money income guarantees provided by SSI will overlap the lower tail of the OAI benefit distribution and not lie very much below OAI median benefit levels even in States which do not provide any cash supplements to the basic Federal Government SSI guarantee. Overlap of welfare cash benefits and the lower tail of the OAI benefit distribution existed under the old OAA program in many States prior to the enactment of H.R. 1 in 1972. The new SSI program will continue this same program relationship and extend it for all the needy aged, uniformly, across all the States.

A hypothetical, drastically simplified example may be useful in illustrating the work incentive problems involved in the relationship between the OAI and SSI programs after 1973.¹⁸ Suppose that after SSI goes into effect, an aged couple is eligible for a combined OAI benefit of \$1,600 a year. Also suppose that the couple has no other sources of income, with the exception of possible cash benefits under SSI and the husband's earnings. Define the following symbols:

Y = Net disposable income of the family.

G = Maximum SSI cash benefit (= \$2,340 per annum).

S = Maximum OAI benefit (= \$1,600 per annum).

E = Earnings of the husband.

t_1 = implicit SSI tax rate on earnings.

(= 0 for $E \leq \$780$ per annum;

= .50 for $\$780 < E \leq$ breakeven level of E for SSI).

t_2 = OAI earnings test tax rate on earnings.

(= 0 for $E \leq \$2,100$ per annum;

= .50 for $\$2,100 < E \leq$ breakeven level of E for OAI).

¹⁸ For a fuller discussion of the OAI and SSI relationship, see Robert I. Lerman, "Incentive Effects in Public Income Transfer Programs," in Subcommittee on Fiscal Policy of the Joint Economic Committee, *Studies in Public Welfare*, Paper No. 4, "Income Transfer Programs: How They Tax the Poor." Washington: U.S. Government Printing Office, 1972, pp. 70-78.

t_2 = OASDHI tax rate on earnings.

(=.0585 for $E \leq \$12,000$).

t_4 = Federal personal income tax rate;

(=.14 plus for $E > \$4,000$).

The breakeven levels for earnings, or the point at which benefit payments are reduced to zero, are \$5,300 per annum for OAI and \$5,700 per annum for SSI in this example. The assumptions about Federal income tax treatment of the couple are that the present tax structure continues unchanged into 1974 and that both husband and wife are age 65 or over and thus receive two personal exemptions each and that they elect to take the low income allowance rather than to itemize their deductions. The example is complex enough as it stands, but the reader is warned that many other details that could be relevant in many cases are ignored to preserve relative simplicity. In particular we ignore differences in accounting periods for OAI and SSI, a factor which in reality makes things much more complex.

Table 1 defines the income possibilities facing the couple under the further assumption that the husband has discretion about whether and how much to work. Up to an earnings level of \$780 per annum, the couple's net income, Y , is given by:

$$Y = S + (G - S + \$240) + (1 - t_2)E.$$

That is, the OAI benefit adds to the net income of the couple only because of the \$240 disregard for all unearned income provided by H.R. 1 in the SSI program. Over this range of earnings, the marginal tax rate on earnings is only the 5.85 percent OASDHI employee payroll tax rate and the incentive for the aged individual to work is virtually equal to his gross market earning power (minus any work expenses he might incur).

Over the earnings range of \$780 to \$2,100 per annum, the family's net income relationship becomes:

$$Y = S + (G - S + \$240) + E - t_1(E - 780) - t_3E = \$2,970 + (1 - t_1 - t_3)E.$$

The marginal tax rate on earnings facing the potential aged worker is now the sum of the implicit SSI 50 percent tax rate and the OASDHI payroll tax rate. For earnings between \$2,100 and \$4,000 per annum, the net income relationship becomes much more complex algebraically as the OAI and SSI benefit formulas interact. The value of the couple's OAI benefit is given by:

$$\text{OAI} = S - t_2(E - \$2,100), \text{ for } \$2,100 < E \leq \$5,300.$$

Similarly, the value of the SSI benefit may be written as:

$$\text{SSI} = G - t_1(E - \$780) - (\text{OAI} - \$240), \text{ for } \$780 < E \leq \$4,820.$$

The family's net income over this range of earnings is then the sum of its earnings net of payroll tax and its net OAI and SSI benefits. After substitution of the assumed values for S and G in this example and after algebraic simplification, the net income relationship can be written again as:

$$Y = \$2,970 + (1 - t_1 - t_3)E.$$

The combined marginal tax rate over this range of earnings remains the same ($t_1 + t_3$) because the reduction in OAI benefits due to the OAI 50 percent earnings test is exactly offset by an equivalent increase in SSI entitlement. The earnings test is not operative over this range of earnings but it does have the effect of greatly increasing the break-even level of earnings for SSI. Above an earnings level of \$4,000 per annum, the Federal personal income tax rate takes effect and the total marginal tax rate includes the relevant personal income tax bracket rate (equals 14 percent on the first thousand dollars of taxable income and 15 percent on the second thousand dollars of taxable income in this example.) Thus, over the earnings range between \$4,000 and \$4,820 per annum, the marginal tax rate increases by another 14 percent, the first bracket rate in the personal income tax.

For the earnings range from \$4,820 to \$5,300 per annum, the net OAI payment is reduced by the earnings test to less than \$240, the amount of unearned income that can be disregarded under SSI. As earnings increase above \$4,820 and the OAI payment is reduced, the balance of the amount which may be disregarded ($= \$240 - \text{OAI benefit}$) is deducted from *earnings* before the SSI marginal rate is applied. That is, the SSI payment is given by:

$$\text{SSI} = G - t_1[E - \$780 - (\$240 - \text{OAI})], \text{ for } \$4,820 < E \leq \$5,300.$$

The effect of this is that the SSI entitlement is increased by 50 cents for each dollar that the OAI benefit is reduced below \$240 per annum. The marginal tax rate over this range of earnings is equal to $(t_1 + t_2 + t_3 + t_4 - t_1 t_2)$. The OAI and SSI marginal tax rates on earnings interact over this earnings range and amount to .75 ($= t_1 + t_2 - t_1 t_2$) before the Federal personal income tax and OASDHI payroll tax rates are added on top. Above the OAI breakeven level of \$5,300 per annum, the earnings test rate is no longer effective and up to an earnings level of \$5,700 per annum, the total marginal tax rate on earnings includes only the SSI, Federal personal income tax and OASDHI payroll tax rates. The SSI benefit formula over this range of earnings reduces to

$$\text{SSI} = G - t_1(E - \$1,020), \text{ for } \$5,300 < E \leq \$5,700.$$

Finally, above an earnings level of \$5,700 per annum, where SSI benefits are reduced to zero by the earnings test, the aged worker faces the same marginal tax rates as nonaged workers.

The example in table 1 presents just one hypothetical case among many, but it has important general implications. Aged households whose general economic status resemble that of the hypothetical household in the example—that is those who are eligible for only low OAI benefits, owning few or no assets, and having low earnings capability—must find the nature of their net income choices most bewildering. In general, such aged individuals will probably conclude that the net gain from continuing to work is quite low, especially if they compare their status to that of nonaged individuals who face much lower marginal tax rates on earnings. It should be noted that Congress in enacting H.R. 1 consciously improved the work incentive features of both SSI (relative to OAA) and of OAI separately, but it is clear from the foregoing example that the work incentive features of the two programs combined is still far from satisfactory. Also,

State cash supplements to the basic SSI guarantee and in-kind welfare programs tied into welfare eligibility will generally compound the work disincentives given in this example and extend the disincentives to much higher levels of earnings.

TABLE 1.—*Hypothetical income possibilities for an aged couple under H.R. 1 if labor force participation (earnings) is a decision variable*

Marginal tax rate	Earnings	Social security (OAI)	Welfare benefit (SSI)	OASDHI employee tax	Federal personal income tax	Net income (equals earnings +OAI+SSI—taxes)
0. 0585<	\$0-----	\$1, 600	\$980	0	0	\$2, 580
0. 5585<	\$780-----	1, 600	980	\$46	0	3, 314
0. 5585<	\$2, 100----	1, 600	320	123	0	3, 897
0. 5585<	\$4, 000----	650	320	234	0	4, 736
0. 6985<	\$4, 820----	240	320	282	\$115	4, 983
0. 9485<	\$5, 000----	150	275	293	140	4, 992
0. 9585<	\$5, 300----	0	200	310	185	5, 005
0. 7085<	\$5, 700----	0	0	333	245	5, 112
0. 2085<	\$6, 000----	0	0	351	290	5, 359

In addition to the problem of work incentives, the present system of income maintenance for the aged makes saving for retirement extremely unattractive for many low-income individuals. If an aging individual or couple can foresee that its total income past age 65 will be less than the SSI guarantee, it will have a strong incentive to dispose of or consume any assets it owns or at least not to make the effort to save and acquire additional assets to finance retirement. SSI will continue the practice of OAA of taxing all income from assets at a 100-percent rate (above the \$240 per annum disregard applying to *all* unearned income) and thus strongly discourage saving by rational low-income households. The assets test for eligibility for SSI benefits obviously adds more disincentives for saving for low-income individuals, at least saving in the form of the financial assets included in the test. Such perverse savings disincentives always existed in the old OAA program, but they will apply uniformly to all the aged after SSI takes effect in 1974 and will affect aged individuals and families over higher ranges of income in the previously low-benefit States.

But the present system of income maintenance for the aged involves much more profound problems for social policy than the built-in work and savings disincentives just discussed. The fundamental problem is that the system creates intolerable horizontal inequities among the aged. Aged individuals receiving SSI benefits can actually become economically better off in the present system (both before and after the enactment of H.R. 1) than previously better off individuals whose total income, including OAI benefits, is too high to make them eligible for SSI benefits. The switch in relative economic status can

occur because the sum of SSI cash benefits plus any State cash supplements plus the imputed dollar value of in-kind benefits such as medicaid that are tied into welfare eligibility can exceed the value of OAI benefits plus income from other sources for low-income retirees. This problem predated the existence of SSI in the States that paid relatively generous OAA benefits; the provisions of H.R. 1 would make this anomalous relationship between OAI and welfare for the aged more uniform nationally.¹⁹ Even if new legislation were to cut existing ties between welfare cash and in-kind programs, the provision of relatively high cash benefits alone under SSI and State cash supplementation has to create some degree of horizontal inequity in that it causes a sharp leveling of individuals who previously enjoyed quite different standards of living.

To take an extreme case, an aged couple whose previous covered earnings entitled them to an OAI benefit of \$195 a month and who had no other sources of income would upon retirement be better off than a previously destitute couple with SSI cash benefits of \$195 a month only to the extent of the SSI \$20 a month disregard on all unearned income. Further, some couples eligible for less than \$195 a month in OAI benefits will not be eligible to receive SSI supplementation up to the \$195 Federal welfare standard because they have financial assets in excess of the asset test maximum for a couple of \$2,250. Under the provisions of H.R. 1, such persons would be forced to choose between disposing of their "excess" assets in return for somewhat higher total benefits immediately or foregoing the welfare supplementation in order to keep all their assets for future contingencies.

A closely related problem with the present system is that it is incompatible with the rationale for the OAI program. The aged couple receiving OAI benefits in the example of the previous paragraph will surely question whether \$20 a month plus the nonpecuniary advantages of OAI over the SSI welfare program are sufficient compensation for the thousands of tax dollars it paid into the OAI trust funds over the working life of the earner.²⁰ Further, it should be noted that the federalization of old-age welfare may well remove much of the welfare stigma associated with the old OAA program and thus tend to blur former distinctions between social insurance and welfare. Academicians will surely point out that once the SSI guarantee plus State supplementation and welfare-associated in-kind benefits approach low to average OAI benefit levels, OAI becomes essentially a welfare system for the low-income aged whose total incomes, including their OAI benefits, are below or not significantly above, the old-age welfare standard.

The argument is basically straightforward. Suppose that the OAI program suddenly came to an end under the extreme case of complete equality in the level of OAI benefits and old-age SSI guarantees. The income of every elderly person without significant other sources of

¹⁹ The 20 percent increase in social security benefits in 1972 made the perversity of the present system dramatically clear. Journalists reported numerous sad cases of individuals whose increased social security benefits made them worse off because their "higher" incomes made them ineligible for welfare cash supplementation and the associated in-kind benefits.

²⁰ This point holds with even more force if both husband and wife had substantial covered earnings prior to retirement. See Pechman, Aaron, and Taussig, *op. cit.*, ch. V, for a discussion of this point. And, of course, the text comparison is for cash benefits only.

income would remain virtually unchanged because welfare benefits would replace the lost OAI benefits. Income taxes would have to rise to finance the higher welfare benefits, thereby substituting for lower OASDHI payroll taxes after the cessation of payment of OAI benefits. Thus, the only consequence of ending the OAI program under these extreme circumstances would be to shift financing of benefits for the aged from the payroll tax to the income tax. Indeed, once people grasp the notion that much of OAI is essentially a welfare program for the aged financed by a regressive tax on wages, they will surely doubt that the program makes sense.

The argument above is certainly oversimplified and subject to the objection by proponents of the present system that the degree of horizontal inequity in the present income maintenance system is tolerable because it affects only a minority of OAI recipients in the lower tail of the OAI benefit distribution and without significant income from other sources. It may further be objected that the advantages of receiving social security income rather than welfare cannot be easily compared in simple dollar terms. These objections have some merit, but in this writer's judgment, they ignore the symbolic importance of even a very few cases of extreme horizontal inequity and in any event do not add up to a strong case. The reader can probably envision many different possible responses to the problems inherent in the present income maintenance system for the aged, perhaps including those to be discussed in the next two sections of this paper. But it should be clear that if OAI is to remain in anything close to its present form and in anything close to its present relationship to SSI, OAI benefits must always be liberalized in the future as the Federal Government and the States raise their minimum welfare standards and their income guarantees under SSI and State supplementation. Otherwise, the present horizontal inequities in the income maintenance system for the aged would affect an intolerably large proportion of the aged population. Large increases in OAI benefit levels may be desirable in the future on many grounds, but it is patently absurd to justify such increases just to preserve the present system of income maintenance for the aged.

A negative income tax or a demogrant program are possible alternatives to SSI as a basic income support program for the aged within a reformed income maintenance system. This possibility is the subject of the next section of the paper. But within the present system, substitution of either of these alternatives for SSI would not solve the basic integration problems discussed above because they would inevitably conflict with the income support function of the present OAI program. For example, suppose that a universal demogrant providing relatively generous benefits to all the aged were substituted for SSI with no substantial concomitant change in the existing OAI program. If OAI benefits were taxed under the demogrant program at a zero or very low rate (perhaps at the rates applicable to ordinary income under the personal income tax), then the demogrant would duplicate the income support function of OAI benefits for the aged, at very great expense to the Treasury. The alternative dual income maintenance system discussed in section IV below would then seem to be superior on every count to the present system. Alternatively, if OAI benefits were taxed under the demogrant program at a special high rate (in the limit, at 100 percent), then the situation would be exactly the same in essentials.

as the present situation. In either case, a demogrant program would be clearly inconsistent with the present structure of OAI.

One last observation can conclude the present discussion. Given the arguments in this section and given the humanitarian case for income support of the aged at relatively generous standards of living, the present income maintenance system for the aged does not seem very attractive for the future. The alternative systems to be discussed in sections IV and V below become correspondingly more attractive despite the likelihood that they pose some transitional problems.

IV. ALTERNATIVE I: A DUAL SYSTEM INCORPORATING SEPARATE EARNINGS REPLACEMENT AND INCOME SUPPORT PROGRAMS

If the present income maintenance system for the aged has two different valid objectives, and if these two objectives are becoming incompatible within the single main program (OAI) of that system, then one possible line of reform is to split OAI into two separate programs. One new program could incorporate the income support functions of both the present SSI and OAI programs while the other new program could be devoted to the single objective of earnings replacement. Such a split of the present system is by no means a new or radical notion. The reports of the 1971 Advisory Council on Social Security contain language that strongly implies support for such a proposal although it does not explicitly call for two separate new programs:

The Council believes that improvements in public assistance programs will reduce pressures to distort the contributory social insurance program. An adequate public assistance program would make it unnecessary for social security to perform functions that are not appropriate to a wage-related program * * *. Social security benefits could then be kept more closely related to a worker's earnings and the length of time he worked under the program, and thus to the social security contributions he had paid than otherwise could be done.²¹

Gordon has discussed the dual approach and has provided some interesting comments on foreign experience with dual systems of income maintenance.²² Bishop has also given serious consideration to what he calls a two-tier system.²³ Most important of all, Buchanan has worked out a detailed scheme of "radical reform" for OAI with careful consideration of the transitional problems involved in moving toward his proposed system away from the present system.²⁴

Let me outline the details of how such a dual system might work, postponing for the moment transitional problems. Income support for the aged would be given over completely to a universal demogrant or negative income-tax type program, the latter perhaps designed along

²¹ Reports of the 1971 Advisory Council on Social Security. 92d Cong., 1st Sess. H. Doc. 92-80. Washington: U.S. Government Printing Office, 1971, p. 3. Also see the discussion of social insurance programs in *Poverty Amid Plenty: The American Paradox*, op. cit.

²² Gordon, Margaret S., "The Case for Earnings-Related Social Security Benefits Restated," *Old Age Income Assurance. Part II: The Aged Population and Retirement Income Programs*. Joint Economic Committee compendium. 90th Cong., 1st Sess. Washington: U.S. Government Printing Office, 1967.

²³ Bishop, George A., "Issues in Future Financing of Social Security," *Old Age Income Assurance. Part III: Public Programs*. Joint Economic Committee compendium. 90th Cong., 1st Sess. Washington: U.S. Government Printing Office, 1967.

²⁴ Buchanan, James M., "Social Insurance in a Growing Economy: A Proposal for Radical Reform," *National Tax Journal*, XXI, No. 4 (December 1968).

the lines of the proposal of the President's Commission on Income Maintenance Programs. Either alternative would provide a minimum income guarantee for all types of economic units, including the aged. OAI would then be assigned a pure earnings replacement objective. The income support program would have to tax OAI benefits at the rates applicable to all other sources of income if this dual system were to be a significant departure from the present SSI-OAI relationship. Since income redistribution would be the province of the income support program in a dual system, OAI as a social insurance program could base its benefit payments solely on considerations of individual or household equity. Once OAI no longer had to provide for the income support of the aged it could be financed at lower payroll tax rates. The payroll tax savings could then be channeled into higher income tax rates to help finance the basic income support program of the dual system.

Simplicity and elementary notions of justice point to the same OAI benefit formula: Benefits payable to an individual or a family unit would be equal to the life annuity value of the present value of its lifetime tax payments to the OAI trust fund. The interest rate used to compute the present value of OAI tax payments would—following Buchanan and based on fundamental contributions to the economics of social security by Samuelson and Aaron—most appropriately be the annual rate of growth of money GNP or some other index of aggregate money economic activity.²⁵ Provided average benefit levels relative to average earnings levels were held roughly constant and provided that the relative sizes of the aged and the working populations did not vary greatly, such a scheme would automatically produce tax revenues sufficient to finance OAI benefits without changes in tax rates.²⁶ The OAI trust fund, as under the present system, would be sufficient if it just covered perhaps 1 year's worth of benefit payments. If, in any year, OAI benefits and taxes did not balance closely, the system would be kept on a current cash basis by payments to, or payments from, general Treasury revenues. A large accumulation of funds in the OAI trust fund in this new pure earnings replacement program would make no more sense under a dual system than it does under the present system.²⁷

The dual system outlined above would solve many of the knotty problems of program integration in the present system very neatly. If

²⁵ Samuelson, Paul A., "An Exact Consumption-Loan Model of Interest With or Without the Social Contrivance of Money," *Journal of Political Economy*, 66, No. 6 (December 1958), and Aaron, Henry J., "The Social Insurance Paradox," *Canadian Journal of Economics and Political Science*, XXXII, No. 3 (August 1966).

²⁶ The statement in the text refers to the effective average tax rate on all earnings. Nominal OAI tax rates would vary with changes in the proportion of total earnings covered and taxed by OAI.

²⁷ This version of an earnings replacement program differs in mechanics from that suggested by Buchanan op. cit., although the basic underlying reasoning is very similar. Buchanan suggests that all individuals be compelled to buy a certain amount of social insurance bonds, which pay a rate of interest equal to the rate of growth of money GNP. His idea is ingenious, but it seems to be a needlessly radical departure from present practices. He also suggests, however, that private firms be allowed to sell securities that would be legal substitutes for the Government's GNP bonds, only provided that firms could provide suitable insurance against bankruptcy. Such an idea is not strictly necessary to his basic plan and it impresses me as a pernicious threat to social insurance. Why should private firms be allowed to select out the best risks from the total population for private profit while the Government is left with all the worst risks?

the income support program in the dual system was of a negative income tax (NEGIT) type, OAI benefits would naturally be included in the definition of income for the NEGIT but, as noted above, would be taxable at a rate well under 100 percent. Thus even for families at the lowest income levels, OAI benefits would always add significantly to total family income, in contrast to the present system. Similarly, income from assets would be taxed under the NEGIT at less than a 100 percent rate, thus increasing incentives to save for retirement for poor families relative to the present system. The level of NEGIT benefits would be of no concern for the viability of the new OAI program in contrast to the present system, since under the dual system, differentials in OAI benefits would always result in corresponding proportional differentials in family or individual net income. The same points hold for a dual system in which the income support function was achieved by a program of universal demogrant. Presumably, OAI benefits would be included in taxable income in the expanded and reformed Federal personal income tax under such a system, while OAI taxes would be made deductible. (Such a change in basic personal income tax law might be advisable as well if a NEGIT performed the income support function, but it would be less essential to integration of the two programs.) Otherwise, integration of OAI and a demogrant program would mesh together just as neatly as OAI and NEGIT in a dual system.

A dual system would permit a scrapping of the earnings test for OAI with a resulting desirable impact on the work incentives for the aged. The earnings test makes sense in the present system only because OAI performs such an important income support role for the aged. The argument for retaining the earnings test under the present system is that it redistributes a relatively fixed amount of funds away from potential beneficiaries who are able and willing to work and thus are relatively well off to beneficiaries who are out of the labor force and thus are relatively badly off. But once the income support function of OAI is given over to a new income support program—either a NEGIT or a demogrant—this redistributive argument loses all force. No redistribution of income will take place within the OAI program in the dual system, since every family's or individual's OAI benefit will be based strictly on the present value of its past OAI tax payments. Under a dual system, work incentive arguments then clearly prevail and call for an end to the earnings test. Aged individuals who continue to work then can reap the benefits both of the additional earnings during their working years and the larger OAI life annuities made possible both by paying more OAI taxes while they work and by retiring at a later age.

This last point also suggests that a dual system could deal very nicely with the vexing problem of early retirement under the present system of income maintenance for the aged. Today, individuals who retire between ages 62 and 65 receive permanently reduced OAI benefits calculated to keep the actuarial cost of their life annuity benefits to the system constant. Unfortunately, early retirees under OAI today are predominantly low-income individuals who cannot afford to receive the lower benefits. This fact leads many people to the observation that OAI fails to support the incomes of early retirees adequately and to the policy prescription that the official retirement age at which OAI beneficiaries can claim unreduced benefits be lowered. But lowering

the OAI retirement age increases the size of the legally defined aged population, with possible serious effects in the long run on the labor force participation of the currently "almost aged" population, and the consequent undesirable effects outlined in section III on OAI costs and the adequacy of OAI benefits.

Under the proposed dual system, a NEGIT or demogrant program would have responsibility for income support of low-income individuals who cannot or will not remain in the labor force up to age 65. Therefore OAI would be under much less pressure to reduce its official retirement age. Individuals who left the labor force prior to age 65 would be eligible for income support payments. Once they reached age 65, their income support payments would be partially supplemented or even replaced by their OAI annuity benefits. Individuals who worked past age 65 would receive larger OAI benefits, for the two reasons noted above.

Alternatively, OAI benefits could be made available prior to age 65 at some specified age such as age 60 or 62 with permanent reduction of OAI benefits as under the present system. The latter alternative has the advantage of making retirement a much more flexible process for the aged individual but has the disadvantage for the economy of providing a certain degree of work disincentives for productive workers under age 65. Either alternative, however, is clearly preferable, in my view, to the present system on both income support and work incentive grounds.

One very significant potential advantage of the dual system outlined in this section over the present system is that it would almost automatically solve the very difficult benefit overlap problems that plague the system today.²⁸ Very briefly, benefits from all public retirement programs, including OAI, railroad retirement and veterans' pensions, would be taxable income under the income support program in the dual system. OAI benefits and other public and private retirement benefits would be quite properly additive. Since OAI benefits would be based on accumulated lifetime OAI taxes rather than on average earnings over some minimum period of OAI coverage, the anomalies that exist today because of individuals who qualify for both Federal civil service or other public program retirement benefits while paying no OAI taxes and for OAI benefits on the basis of minimal OAI-covered employment would automatically be resolved. Under the present system, coverage requirements for OAI benefits are extremely liberal and the minimum benefit is high relative to average OAI benefits because of the OAI income support function. The liberality of OAI coverage requirements and the shape of its benefits—average earnings curve in the present system are intended to help the poor but they also create inequities when well-off individuals use these provisions to qualify for dual public retirement benefits. Under a dual system, however, a NEGIT or a demogrant would absorb the current income support function of OAI, and the OAI minimum benefit could quite properly be reduced literally to zero. Dual entitlement to retirement benefits would thereby no longer be a problem.

²⁸ These problems are discussed in detail in James R. Storey, "Public Income Transfer Programs: The Incidence of Multiple Benefits and the Issues Raised by their Receipt," Subcommittee on Fiscal Policy of the Joint Economic Committee, *Studies in Public Welfare*, Paper No. 1. Washington: U.S. Government Printing Office, 1972.

A dual system would also solve another inequity in the present system, the unfair treatment of married women with substantial labor force experience under OAI. The unfairness arises because OAI taxes are paid on the basis of *individual* earnings while OAI benefits are paid on the basis of the married couple. Thus, the combined individual OAI benefits of an aged husband and wife who both have worked and paid OAI taxes over a lifetime may not exceed the husband's benefit plus the 50 percent wife's benefit payable even if the wife had never worked. This inequity again arises because the income support function of OAI calls for a benefit amount based on presumed family need, and presumed family need is greater for a married couple than for a single individual. The inequity is obvious and it could be alleviated by various ad hoc methods under the present system.²⁹ But note that under a dual system, the problem would vanish automatically because of the strict adherence to the principle of individual equity in the restructured OAI program. Total family OAI benefits under a dual system would depend only on the present value of total family lifetime earnings, and would simply be the sum of husband's and wife's benefits based on the earnings history of each. The present inequity against married working women would no longer exist. Similarly, the present differentiation between employees and the self-employed in OAI would no longer hold in the dual system. OAI benefits would depend only on the total tax payments attributable to any individual worker. If the self-employed continued to pay only three-fourths or less of the total employer-employee OASDI tax under the dual system, their benefits would also be correspondingly smaller.

Finally, note that almost everything said about OAI in the foregoing discussion is also applicable to the survivor's insurance program (SI). OAI and SI would remain linked as OASI in the dual system, just as in the present system, but SI benefits would be computed without regard to redistributive considerations. SI benefits in the dual system would appropriately be based on *average* earnings records, however, just as in the present SI program, rather than on accumulated tax payments as in OAI. The rationale for this difference in benefit computation is the difference in the functions of the two programs; SI is basically a group life insurance program and its benefits should bear a relationship to average premium payments rather than to accumulated premiums. But SI benefits under the dual system would not necessarily vary with family size or presumed need as under the present system.³⁰ The income support program of the dual system would provide for direct redistribution of income if necessary to survivors on the same basis such redistribution would be provided to other kinds of needy families.

One last matter remains to be discussed here, the problem of transition from the present system to the proposed dual system of income maintenance for the aged. Once a universal income support program was put into effect, how could OASI adapt over time to its new pure earnings replacement role? No one answer could possibly cover all reasonable responses to this enormously complicated question.

²⁹ See, for example, Pechman, Aaron and Taussig, op. cit., ch. V.

³⁰ The choice between the present system and a strict private insurance model on this issue is not clearcut. Congress could reasonably opt for either alternative and remain within the framework of the dual system.

If our society makes the judgment that it is irrevocably committed to the current rules and benefit schedules in existing social security legislation for all individuals already in the labor force who have paid any social security taxes, then the transition period from the present system to a dual system would be a very long one. Any new legislation establishing a restructured OASI program would apply necessarily only to new entrants into the labor force and the dual system would evolve out of the present system gradually over three or four decades. A simple option rule could probably greatly speed the transition process, however. Every individual already in the labor force could be given the option of receiving benefits based either on the computation formula of the present law or on the formula of the new law. A necessary exception to this option rule is that individuals who elected to receive benefits under the new income support program of the dual system could not also elect to receive OAI benefits computed under the existing law. (If the minimum income guarantee under the new income support program were as high as the present SSI guarantee (plus the SSI disregard on unearned income) then the option rule would protect individuals from a decrease in net income.) Without such a provision, needless duplication of income support payments would result as well as the creation of new horizontal inequities among the aged. Such an option rule would inevitably involve some increase in the costs of the income maintenance system for the aged to the Government.

If Congress were unwilling to allow the transition period to go on as long as 30 years or so, it could speed the process greatly in a number of ways. For example, it could make the rules of the new OASI program apply automatically to all individuals currently far from retirement; say, to everybody under age 50. Another possibility would be to combine the option rule outlined above with a freeze on OASI benefit levels scheduled under existing law at their present dollar levels for all new benefit awards. Increases in benefit levels to offset inflation or for other reasons would thus be limited to existing beneficiaries. A less drastic version of this last measure would be to confine such a freeze *cum* option to all new benefit awards after a transitional period of perhaps 10 or 20 years. These frozen dollar benefit levels in the existing OASI benefit schedule would then become rapidly very unattractive relative to benefit levels under the new OASI program as earnings levels increase over time because of productivity growth and inflation. Other techniques could undoubtedly be devised to speed the transition to a dual system. Congress would face difficult tradeoffs between speeding the transition period and either incurring large transitional costs or violating implied benefit commitments to the aged under social security.

In principle, then, the transition from the present system of income maintenance for the aged to a dual system seems to be a manageable problem. This is not to deny that the technical problems of transition could be enormously complex, especially if the transition period were a short one. But this is rightfully the subject of another, much longer paper. The political feasibility of effecting such a transition within our political system is another moot issue beyond the scope of the present paper. But if a dual system is judged to be sufficiently better in relevant respects than the present system, these difficulties should not be used as an excuse to avoid thinking about and acting on change.

Both the technical and political problems of a transition to a dual system would certainly be no more difficult than the similar problems involved in initiating the programs enacted in the Social Security Act of 1935.

V. ALTERNATIVE II: A UNITARY SYSTEM OF INCOME MAINTENANCE FOR THE AGED

The second alternative income maintenance system for the aged considered in this paper involves the separation of the aged from the nonaged populations for income maintenance purposes. This alternative merits serious consideration because of its relatively high political feasibility. The Congress has time and again demonstrated its determination to treat the aged more generously than the general population in many areas, but especially in income maintenance programs. (The provisions enacted in 1972 in H.R. 1 provide just one more example of this point.) A world that could easily develop in the future with only minor transitional problems would have roughly the following characteristics: Income maintenance for the general population would continue along present lines; or would be redesigned to be something like President Nixon's proposed family assistance program or would be handled by a universal (except for the aged) demogrant program. In any event, it would not apply to the aged except that benefit levels provided for the nonaged would obviously set some sort of minimum standard for the aged as well. Income maintenance for the aged would then involve a mass blanketing-in of all the aged under OAI or a similar program with a new label, and SSI for the aged would be abolished.³¹ In short, the problems of the present system outlined in section III of the paper which arise from the uneasy relationship of SSI and OAI would be resolved by coordination of all income support and earnings replacement functions for the aged within a single income maintenance program.

The benefit structure for the aged within a single program would involve elements of both income support and earnings replacement, just as in the present OAI program. It could in principle be made identical to any given combined benefit structures of a dual system. That is, the minimum benefit in the unitary system could be set equal to the guarantee level of the income maintenance program in the dual system. Increments above the minimum benefit in the unitary system could then equal the level of benefits provided under the earnings replacement program of the dual system less losses of benefits under the income support program. These losses would occur because dollars of income above the minimum income support benefits would be "taxed" (would reduce benefits). Past the breakeven point of the income support program the increments would be set equal to the amounts provided by the earnings replacement program of the dual system without any reduction.

An example can help to illustrate the possible identity of benefit structures under hypothetical dual and unitary income maintenance systems. Suppose that the guarantee level in the income support program of a dual system were \$200 a month for a given type of family unit and that the offsetting tax rate in the program were 33⅓ percent. Then if an aged family of this type were entitled to \$100 a

³¹ For one proposal in this spirit, see Bruno Stein, *On Relief*. New York: Basic Books, Inc., 1971, pp. 109-111.

month from the OAI program of the dual system and had no other income sources, its net income would be \$267 a month ($= \$200 \text{ income support guarantee} + \$100 \text{ OAI benefit} - .333 \times \$100 \text{ income support program tax}$). Similarly, if its OAI benefits were \$200 a month, its net income would be \$333 a month under the same assumptions. That is, up to its break-even level of nontransfer income (consisting only of OAI benefits in this example), its net income would rise by 66⅔ cents for each additional dollar of OAI benefits to which it was entitled. Above the break-even level of income—\$600 in this example—each additional dollar of OAI benefits would add a full dollar to net income. A unitary income maintenance system could in principle duplicate this benefit structure within a single program, at least under the circumstances assumed in this example. The minimum benefit payable to an individual with no covered earnings would be \$200 a month. Increments above the minimum benefit would then be \$67 a month for each \$100 a month life annuity the family unit was entitled to on the basis of its earnings record up to the point where OAI benefits reach the \$600 level. Above that level, OAI benefit increments would rise by a full \$100 a month for each additional \$100 life annuity “due to” the family.

This example demonstrates only the logical possibility of identity of the benefit structures in hypothetical unitary and dual systems. In practice, substitution of a dual system for a unitary system (or vice versa) would almost certainly not leave the benefit structure unchanged. Instead, under the unitary system, increments above the minimum benefit level would probably be determined according to the ad hoc methods now used in OAI, with the probable (but not necessary) result that the earnings replacement function of the unitary system would be deemphasized to some degree in favor of the income support function.

A related issue concerns the nature of an earnings (or income) test, if any, in a unitary system of income maintenance for the aged. As in the present system, the temptation for humanitarian administrators and legislators would be to institute relatively tough earnings (or income) tests in the unitary system to redistribute income from the relatively well off to the relatively poor aged. The blanketing-in of all the aged in a unitary system would certainly give it a much stronger income support image than exists today for OAI and would reinforce this temptation. Since blanketing in all the aged would undoubtedly be accompanied by a large infusion of funds from general revenue sources to the OAI trust fund to supplement the present tax on wages, Congress would probably put great pressure on the old-age income maintenance administrators to reduce costs as much as possible. An earnings or income test for retirement benefits is an obvious response to such pressure. For these reasons, it is tempting to conjecture that an earnings test or an income test would be much tougher in a unitary system than in the dual system discussed in section IV above. Also, of course, the earnings or income test under the unitary system would have much more universal scope than an income test under the income support program of a dual system since the latter would apply directly only to those aged individuals with very low incomes. Therefore, a unitary system of income maintenance for the aged is likely to involve greater work disincentives than a dual system. If an income test in a unitary system replaces the earnings test under OAI in the present system, it will involve greater disincentives for saving as well.

The validity of these conjectures depends, of course, on the precise details of any real world unitary or dual system of income maintenance for the aged. Generalizations about the exact nature of hypothetical alternative programs are risky.

A unitary income maintenance system for the aged is essentially simple and involves only a few problems requiring explicit discussion. The first of these problems is the appropriate means of financing the system. As noted above, a unitary system designed along the lines suggested here would be so openly an income support program that it would call for at least partial general revenue financing. The payroll tax would still be very useful for benefit computation purposes, however, and should probably be retained in form, but definitely not in substance. A very simple method of restructuring the payroll tax along desirable lines in a unitary system is to make all or part of the employee's share of the tax just a withholding device for the personal income tax. This objective could be accomplished by allowing the employee share of the tax to be claimed as a credit against the personal income tax, and to refund the full amount of any excess of the sum of the credits for all workers in a family over the personal income tax liability of the family.³² To restructure the payroll tax even more drastically, all or part of the employer share of the tax could be allowed as a credit against either the corporation income tax or the personal income tax of the proprietors of an unincorporated business. The credit device would leave the records and finances of the OASI trust fund intact but would remove all regressive elements from the tax side of social security. Of course, personal income tax rates would have to rise correspondingly to meet the cost of the payroll tax credit.³³ In contrast, the dual system would leave the payroll tax intact in its present form, except that rates could be reduced to match the savings of removing all income support elements from the OAI program. In both systems, however, the net result should be a reallocation of the tax burden away from social security payroll taxes to income taxes in order to finance income support of the aged out of a more progressive source of revenue.

A very difficult problem for a unitary system would be the overlap of public retirement benefits that plagues the present system. This problem is difficult to solve in the present system because of institutional inertia and reinforcing political pressures exerted by public sector employees. A new universal income maintenance system for the aged could solve this problem at one stroke by simply making its coverage of earnings universal and blanketing in all public employees for basic retirement benefit coverage. Then all public employment benefit programs could be converted into a public sector analog of present private pension programs, with benefits under these programs

³² See Pechman, Aaron, and Taussig, op. cit., ch. VIII, for further details about this technique.

³³ A tax credit to employers for their share of the payroll tax may seem a strange and regressive tax proposal on first encounter. But note that the text discussion couples this proposal with a general increase in income tax rates to maintain a constant total tax yield to the Treasury. The purpose of such a tax credit would not be to provide tax relief to employers, but rather to increase the demand for labor, which is a function of the gross wage including payroll taxes. If modern tax incidence theory is correct, the long-run result of the tax credit would be a progressive shift in the overall tax burden away from wage incomes covered by OASDHI to all incomes.

designed to be essentially supplementary to the basic OAI retirement benefit program. To venture a guess about political realities, such a reform would be as difficult to effect within the framework of a unitary system as it is in the present system. Veterans' pensions would present perhaps an even more embarrassing political issue for a unitary income maintenance system for the aged. These pensions are essentially welfare payments for veterans and their dependents and survivors since there is no requirement that the veteran have incurred a service-connected disability. Thus, in principle such benefits should simply be abolished under a unitary system, especially if the minimum benefit provided by the new OAI program for the aged were set at a high enough level. To allow veterans' pensions to be additive to the benefits provided by the old-age income maintenance program would be to permit all sorts of horrible horizontal inequities. But political realism suggests that the latter course would be the one adopted by the Congress.

A critical problem for a unitary system would be the exact definition of the aged population and the coordination of income maintenance programs for the aged with other social security programs directed at the nonaged population. Age 65 or any other single age is an arbitrary and artificial boundary between the nonaged and the aged. But in the unitary system envisioned in this section of the paper, the choice of the critical retirement age is all important if there really is to be a separate income maintenance system based on age. One immediate problem with no obvious resolution is the issue of early retirement which would arise regardless of the age chosen to be the official retirement age. Just as in the present system, a unitary income maintenance system for the aged would face the dilemma either of allowing early retirement with reduced benefits or denying benefits to early retirees (who may or may not qualify for income maintenance benefits for the nonaged). In either case, the income support functions of the system are clearly going to be unsatisfactory to some critics. A related problem suggested by Hollister is that if benefit levels in the income maintenance program for the aged substantially exceed the benefit levels available for the nonaged, then there will be some incentive to shift dependents from nonaged to aged households.³⁴ This point is just one more example of general perverse incentive problems with all categorical income maintenance programs.

A further, related issue concerns current social security programs directed at the nonaged groups in the population: dependent survivors of workers covered by OASDHI and (some) disabled workers. Should such groups be treated as "honorary aged" as a matter of social policy and given benefits greater than the benefits provided for other nonaged needy groups not covered by current social security programs: (the blind and mothers with dependent children, for example)? The differences in treatment between nonaged needy groups covered and not covered by OASDHI are embarrassing enough in the present income maintenance system in the United States with its artificial dichotomy between social "insurance" and welfare. They would become much more embarrassing in a world in which old-age assistance is abolished and all the aged are blanketed in a single categorical income maintenance program. No obvious best solution to these quandaries suggests itself to me.

³⁴ Hollister, *op. cit.*

Alternative Income Maintenance Systems for the Aged

The dual and unitary systems have been intentionally posed in this paper as clearly defined alternatives. Presenting them in this light is a useful expository device but it does not give a full description of the choices actually open to reformers of the present system. Elements of both systems can be incorporated more or less logically into some alternative system. For example, one possible alternative system might include a system of universal demogrant graduated by age to favor the very old plus an old-age retirement program with a strict earnings replacement function. This alternative is, of course, very close to the dual system outlined in section IV in essentials. Another alternative, much closer to the unitary system outlined in this section of the paper, would combine a demogrant for the aged plus an old-age retirement program with much less of an income support function plus a separate income maintenance program for the nonaged, perhaps in the form of a negative income tax device. Such alternatives blur the distinctions drawn in this paper between the dual and unitary systems, but the basic integration issues are much the same.

As should already be very evident, my own view is that a dual system approach to income maintenance for the aged is preferable to an approach along the lines of a unitary system. My preference for the dual system is based partly on the grounds that it seems to offer clear technical advantages over the unitary system in solving the vexing integration issues of the present system. But the dual system also seems to me to have broader social and political advantages in that it treats needy people of all ages on a par and clearly separates the two legitimate functions of income maintenance—income support and earnings replacement—into two mutually consistent programs. Such a separation seems desirable to me because it forces the Congress to make explicit decisions about both kinds of programs and therefore makes it more likely that both functions of income maintenance will be done justice.

PROGRAMING INCOME MAINTENANCE: THE PLACE OF UNEMPLOYMENT INSURANCE

By RAYMOND MUNTZ*

SUMMARY

This paper assesses the economic contribution of unemployment insurance (UI), evaluates the degree to which welfare reform measures can substitute for UI, and assesses the design problems that arise in attempting to coordinate UI with several welfare alternatives.

Whether to continue the UI program depends both on assessment of its merits and shortcomings, and on the claims of a substitute program.

In part I, the following shortcomings are discussed: UI is a decentralized program with uneven performance; it uses the trust fund mechanism; it creates benefit inequities among the States; it only partially follows wage insurance principles because of conflicts between benefit and tax objectives; and, although it gives favored treatment to low-income beneficiaries, only a fifth of total UI resources go to the lowest income families.

Among its strengths are: it provides compensation as needed to covered employees, thereby alleviating the impact on workers of an uncertain economic system; it provides benefits, in the early stages of a recession and to some degree offsets the force of the downturn; it compensates those directly affected (an important equity consideration); finally, it is responsive to economic security needs of individuals and regions, yet maintains speed of payment without a needs test.

Some inefficiency could be eliminated or lessened. To improve trust fund use might require basic structural change such as a national program with a single fund. However, the wage insurance features could be improved within the existing framework through Federal benefit standards.

The last shortcoming, in not meeting a poverty efficiency criterion, cannot be corrected within the system, at least not so as to make any substantial difference in the overall distribution of income. UI has always received its greatest support when it was explicit about who was not entitled to benefits and when it was clear that economic distress as such would have no part in determining entitlement.

But to explore the mission of UI is to come to the conclusion that income maintenance plans are needed, not as substitutes for UI but in addition to it. UI is for those with interrupted work histories, those who want work and are unable to find it, and those with skills to

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keep until they are again demanded. It is not for those who are unemployable; nor for those who have obligations that prevent them from being in the labor market; nor is it sufficient for those with incomes far below their minimal needs. UI contributes significantly to the prevention of poverty by cushioning against income slides that otherwise can lead to deterioration in morale and family structure. But a strategy for abolishing extant poverty must work through broadly based programs directed to the lowest income families.

Part II is concerned with whether income-tested or demogrant plans are to be preferred for this purpose. The focus is not with the merits of income maintenance plans but on their capacity for integration with UI. The finding is that program integration can be achieved with both types but more easily with the demogrant.

An income-tested plan must provide for some regional variation in the "guarantee" in order to fit well with UI. It should also allow some disregard in considering UI as income, though it cannot go so far as to treat UI benefits in the same manner as earnings. By introducing incentive principles in UI partial benefit schedules, the increase in implicit tax on earnings will be minimized. In these ways it is possible to preserve the vitality of two related systems so that UI is not eclipsed, and so that recipients can be guided by an understanding of their interests, particularly in terms of additional work.

The adaptation of UI to an income-tax-credit demogrant is comparatively simple. The only problem occurs because of the higher withholding rates on earnings. The smoothest adjustment would be to require that UI benefits be taxable under the Federal income tax in order to maintain some distance between wages and take-home pay. (This is a change that on equity grounds would be desirable even now if the benefits were at their proper levels.)

Finally, if a demogrant is selected as the preferred style for income maintenance, should the payment period be short term or annual? If the demogrant is conceived of primarily as a reform of the income tax structure, with the accounting and reporting system much as it is now, integration with UI offers no further problems. But if a support element can be introduced where weekly or biweekly checks are mailed out to net gainers, then interesting opportunities arise with only minor additional difficulties.

A "support demogrant" that makes weekly or biweekly payments would resolve difficult policy issues that have plagued UI, issues about qualifying wages and the duration of benefits. With unemployed (as well as employed) persons receiving weekly or biweekly support checks, UI could concentrate on its insurance mission for regular employees without conflict about the eligibility of marginal workers or the continuing labor market attachment of the long-term unemployed. In addition, with the help of an 80 percent limiting formula for extreme cases, UI and demogrant combined would modify transfers to the unemployed in desirable ways, by enlarging payments for larger families and lower income workers.

These advantages of an integrated system are achieved without sacrificing the concept of earned benefit rights. While the purpose of the "support demogrant" is tax reform and more equal incomes, an important byproduct could be sharpening the objectives of UI.

INTRODUCTION

Historically, this country has pursued a categorical and contingency approach to income maintenance. In launching each new program our lawmakers have proceeded with an idealized target population, an image of who needs help and why. These images have been useful because they distinguished, or tried to, between those deserving and those not deserving of public support.

The liberalization and multiplication of separately conceived programs cannot continue for long. There necessarily comes an end to the time when social security programs can lead their careers in isolation, and we must face the problems of program interrelation. The categorical approach itself is ripe for reexamination.

The distinction between the "deserving" and the "undeserving" becomes much less meaningful when the elimination of poverty itself has become a national goal. This goal is realizable if we wish it, but not if we believe some should be poor and some should not.

One broad strategy is to eliminate poverty through the redistribution of income.¹ Proposals for negative taxes and demogrant as practical ways to accomplish this are abundant. Enactment of new programs would mean substituting them for or integrating them with existing social security-style programs.

This essay explores such alternatives as they affect unemployment insurance (UI). In order to provide data for an informed judgment, we attempt to do three things: (1) to make an assessment of the economic contribution of UI; (2) to evaluate the gains and losses associated with program substitution and with integration; (3) to assess the design problems that arise under integration.

It is my hope to shed light on questions that will be of increasing interest. What are the objectives of UI in the modern age and how well are those being fulfilled? Should the program be altered to contribute toward the national objective of eliminating poverty? Can any other program substitute for unemployment insurance or provide as wide a range of benefits at a lower cost? If UI is integrated with other income maintenance plans, will its benefits be treated as wages or in some other manner? Is there any reason to change the mission of UI? What are the implications of any new income maintenance proposal for benefits, for the work test, and for the financing of UI?

PART I. ASSESSMENT OF UI

The Interested Parties

The economic effects of unemployment insurance must be viewed in terms of the interests of the parties involved: the Government (both Federal and State); business enterprises; and most particularly, the wage earner and his household. Each of these parties has economic management problems in which UI plays a role. Here we will look at

¹ The political legacy of the sixties set new goals and new challenges which left their mark on economics. From the issues of stabilization, full employment, and growth that were in the forefront for three decades, economics has turned increasingly to another old issue, that of redistribution. A great deal can be learned by applying income distribution analysis to the effects of the American system of social security, provided it is done with sufficient judgment so as not to overlook other program values that have come to us from past struggles.

the particular concerns of each party. Since UI is a funded tax-transfer program, it will help to distinguish separately how each party regards benefits, taxes, and the performance of the trust funds.

GOVERNMENT AND BENEFITS

The history of industrialization involved the formation of new social classes which have a role and a stake in economic growth. Labor legislation and social insurance were provided to encourage the working classes and to recognize their social contribution by protecting them from some of the negative effects of industrialization. Unemployment insurance was conceived to unburden workers of some of the cost of wage loss from unemployment which often is normal in a market economy. The benefits of a market economy cannot equitably accrue to the entire society while one portion of the society bears a disproportionate share of its costs.

In countries without UI, there are restrictions on the rights of employers to lay off employees or to close a business. This country has preferred to leave capital unfettered in its movements and to compensate the workers adversely affected. Unemployment insurance is directed to meeting the social costs associated with mobile capital markets.

This is an application of welfare economics whereby part of the society may be compensated for loss in order that the whole society can advance. We can call this a "compensation" objective of UI.

Is there also an "insurance" objective, achieved by pooling the unemployment risk? Certainly some kinds of unemployment are insurable; for example, the normal business failure that can be expected in a free economy. Temporary unemployment in such cases is caused by events independent of each other, the criterion of an insurable risk. But the dynamics of the business cycle may cause unemployment that does not meet the insurance criterion. Recessions and depressions involve reciprocating interdependencies that add up to market failure. In these situations, unemployment is not caused by independent events and is not insurable. This was dramatically demonstrated by the Great Depression which wiped out privately established unemployment benefit plans.

Whether considered as "compensation" or as "insurance" or both, unemployment benefits cannot be undertaken privately, and have to be a "public good." Modern public finance finds Lincoln's statement to the point: "The legitimate object of government is to do for the people what needs to be done, but which they can not, by individual effort, do at all, or do so well, for themselves."

GOVERNMENT AND THE UI TAX

The imposition in 1935 of a Federal unemployment tax on payrolls was more for the purpose of encouraging State action than for defining the nature and purposes of unemployment insurance. Although the Social Security Board provided guidance, the benefit and financing policies were left for State determination.

Universally, the States followed the Federal lead in adopting a payroll tax. The choice of the payroll tax was a crucial decision. It fit the general philosophy of social insurance, but exclusive reliance

on the payroll tax was a peculiarly American emphasis. The payroll tax was even extended to what might have been more properly financed through general revenue; namely, the manpower activities of the employment service.

The exclusive use of the payroll tax and the complete absence of general revenue financing would appear to give a very secondary role to income redistribution. The primary objective was to allocate the social costs of unemployment to those responsible. This notion of attributing costs was emphasized further as States adopted experience rating, which assigned the tax burden according to the efficiency of the enterprise.

GOVERNMENT AND THE TRUST FUNDS

A program using trust funds assures that money for benefits is available when needed. However, an additional argument for a trust fund program was that of preventing unemployment through fiscal policy. It was contended that the State trust funds would fluctuate with business conditions and provide some countercyclical stabilization.

In practice, only one or two States have emphasized this objective in the management of their funds. Why has this professed objective been ignored? We shall see below that employer interest in the trust funds runs somewhat counter to the Government objective. State-by-State administration has contributed to diluting this objective, because it removed fund management from the intense public scrutiny a single fund would have received.

Of less importance is the fact that decentralized funding means larger total reserves than would otherwise be necessary. (There is a small reinsurance fund from which the Federal Government can make loans to States in trouble, but in general solvency is a State concern.) Pooling of the risk nationwide would have required smaller reserves.

There have been some proposals for investing these reserves in manpower programs, but underwriting and solvency objectives could be compromised by adding another purpose even if it were also one of raising employment levels. Other countries have used their funds in manpower programs, but this is easier to justify where there is at least some financing from general revenues.

EMPLOYERS AND THE UI TAX

The massive layoff of workers was the occasion for adopting unemployment insurance, but support for these workers was not the only or even the most important goal as seen by employer spokesmen. They viewed layoffs as a sign of economic disorganization. Along with the "Wisconsin School" of economists, they stressed the responsibility of business to correct this defect in its performance. It was this prevention argument that justified experience rating the UI tax, that is, varying each employer's tax rate with the benefit claims experience of his firm. Those who had doubts about the prevention effect of the variable tax still thought it safer to stick with what Edwin Witte called "prevailing American concepts." "Honest cost accounting," he said, "requires that all costs be ascertained and properly allocated to the commodities produced or services rendered. An industry which operates intermittently occasions great costs to its employees and to

society through its methods of operation * * *." ² Others of the Wisconsin school, notably Arthur Altmeyer, changed their minds after seeing some of the effects of experience rating, but it has continued to be an article of faith with employers and some experts. There is still an intense dialog among employers about how closely benefit experience should be mirrored by tax experience. Certain seasonal and unstable companies which pay the maximum tax rates but whose employees draw much more in benefits than the total company contribution are thought to be shifting some of their wage bill on to other sectors.

The idea that UI taxes can stimulate better employment practices and reduce unemployment has diminished in importance as fiscal and monetary authorities assumed more responsibility for economic stabilization. Irregular employment has also been greatly reduced through the influence of unions, management personnel policy, and labor law. The supporters of experience rating have shifted ground. Experience rating is now favored to encourage employer interest in the program policies and administration and to keep benefits and taxes "reasonable." Among economists, however, there is some new interest in raising maximum tax rates so that inefficient seasonal employers will either be put out of business, or required to reduce seasonality.

EMPLOYER VIEW OF BENEFITS AND THE TRUST FUND

The business community emphasized that UI benefits should be directed to the more deserving workers and that benefits must not impinge on economic incentives. It is argued, for example, that when benefits rise above half of wage loss, we enter an area where the value of leisure offsets the loss in income, particularly when take-home wages are reduced by taxes and other deductions. For the same reason, maximum benefits relative to wage levels have been pegged lower than they were at the beginning of the program. Most States still have the "waiting week," because of fear UI will be abused. The penalties for disqualifying acts have been made more severe than they were in the early years of the program. On the other hand, the main way in which benefits have become more liberal is through extension of the duration of benefits. Here the employers have pushed for variable duration under which the longer-term, steady employee is allowed benefits for a longer time. Business has also urged programs for more rapid reemployment and a stricter application of the work test. Business has opposed Federal benefit standards, both because of their liberalizing effect and because Federal standards would take policy control away from the State level where business is more certain of its influence.

Employer policies regarding trust funds appear to be a function of their attitude toward benefits. They point out that large funds built up in good times are an invitation to benefit liberalization that will lead to a higher cost program. The reserves built up during World War II were really not dissipated until the middle 1950's, and in the interim it was frequently possible both to reduce tax rates and to liberalize benefits, a luxury that is possible only with large trust funds.

² *Social Security Perspectives: Essays by Edwin E. Witte, Robert J. Lampman*, ed. (Madison: The University of Wisconsin Press, 1962), p. 274.

There has been some reluctance in the business community, at least in a number of States, to look favorably on automatically self-adjusting trust fund devices that would assure solvency over the business cycle. Several States, at employer urging, seem to prefer to adjust tax rates legislatively every year or two to keep fund levels at the minimum necessary for the immediate foreseeable future. This view, of course, is inconsistent with the Government objective of achieving counter-cyclical effects.

EMPLOYEE VIEW OF BENEFITS

For employees, UI benefits are compensation for part of one's wage loss for a limited time during layoff. The benefits provide support that makes it possible for the worker to ride out a temporary job shortage in his field and to retain his investment in his training and experience.

In the early debates about social insurance, the labor movement was divided. The skilled trade unions around Gompers were suspicious of Government programs, but others, such as the International Ladies' Garment Workers Union and others with a mass base favored unemployment insurance, as did the American Federation of Labor (AFL) itself by the time of the depression.

Labor has put its emphasis on wage replacement, rather than social minimums, because it wanted to keep the program as free from a welfare approach as possible. Each worker's primary concern is his own standard of living; and since his wage is the best indicator of that, benefit formulas should be based on individual wage levels.

This replacement concept has been threatened by the long run historical rise in wages and the lag in adjusting the maximum benefits. Rising wage levels require updating the weekly maximums. Union policy emphasizes the percentage or flexible maximum that ties the maximum to average wage levels and preserves the effectiveness of wage replacement.

At one time there was a difference between AFL and CIO spokesmen on whether to add dependents' benefits. The CIO thought this was the only strategy to achieve liberalization. The AFL felt this compromised the wage insurance principle. AFL-CIO policy now favors dependents' allowances that are clearly distinct from the wage insurance basic benefit.

Unions have urged universal coverage, have opposed the stiffer disqualifying penalties, and have worked to lengthen duration of benefits. In general, employees and unions have devoted their policy efforts more to updating benefit levels than to challenging the incentive norms built into the benefit structure.

EMPLOYEE VIEW OF UI FINANCING

Employees have an interest in the UI tax even though it is paid by the employer. In competitive industry with high unit wage costs the employee may actually be paying all or part of the tax through wages lower than they otherwise would be.

There are labor spokesmen who think the UI program would have a better benefit structure today if the payroll tax had included explicitly an employee contribution. This might have given labor more policy leverage, that is, more influence with State legislatures, and

would have avoided the effects of experience rating. However, there is wide acceptance of the employer-paid tax as the exclusive source of UI financing. This is consonant with other efforts by labor to shift the cost of such fringe benefits as health insurance and pensions to the employer.

Labor has opposed experience rating on several grounds: First, that it has no demonstrable effect on employment stabilization; second, that it compromises the primary purpose of providing adequate benefits by stimulating opposition to benefit claims and amendments needed for updating benefits; and finally, that it undermines the solvency of the program.

Trust fund financing of UI assures the employee that his benefit will be paid even if his company goes out of business. It is important, then, that the trust fund be solvent in terms of the benefit liabilities. This solvency should be measured in terms of potential liabilities in bad times as well as good, in labor's view.

* * *

This review of the structure and dynamics of UI points to its purposes and to some of the conflicting interests of the parties. These can be quickly summarized with the aid of a table as follows:

Benefits	Taxes	Trust funds
<i>To Government:</i> Are compensation for social costs of unemployment.	Attribute cost to parties involved, with no charge to general revenues.	Should have counter-cyclical stabilization effects.
<i>To employers:</i> Must be consonant with market incentives and directed to the most deserving employees.	Are experience-rated for unemployment prevention and claims control.	Should be currently solvent.
<i>To employees:</i> Should support standard of living of all wage and salary employees, and should respect the recipients.	Are premium contribution in lieu of wage increment.	Should be solvent over the cycle through automatic adjustments.

This matrix sums up an inductive approach to finding the purposes of UI. While there are areas of agreement, there are many conflicts. It is tempting to prefer the purposes of government and read horizontally. There are fewer conflicts when the table is read horizontally than when it is read vertically, and the interests of employers and employees are secondary to those of government. But this would oversimplify the process of defining objectives because the spokesmen for employers and employees actually shape the program.

Analysis of objectives has been given a new perspective by economists who argue that the conflicts in objectives arise because UI tries to make one response to unemployment of different kinds. One such study by Charles Warden, Jr.³ distinguishes two kinds of

³ Charles Warden, Jr., "Unemployment Compensation: The Massachusetts Experience," in *Studies in the Economics of Income Maintenance*, Otto Eckstein, ed. (Washington, D.C.: The Brookings Institution, 1967), pp. 73-96.

competing goals. On the one hand, there is the attempt to finance recession-caused unemployment, which argues for larger benefits of longer duration paid for through level taxes or financed from general revenues. On the other hand, there are objectives relating to personal wage insurance and company behavior that are oriented to unemployment of the trend, irregular, or frictional variety. Here benefits must be keyed to previous income experience and reserved for workers with well demonstrated attachment to the labor force; experience rating is appropriate to assign accurately social costs and stimulate change in use of resources. The source of confusion about these contradictory objectives, Warden finds, is in views expressed by the Government spokesmen instrumental in drafting and passing the Social Security Act.

In response to this thesis, I would argue that the reasons for unemployment can be classified in various ways but such classifications change with economic understanding. Underlying all particularistic explanations is the free movement of capital and the negligible labor market assistance that workers receive from Government. When seen from the worker's point of view, it is unemployment as such that is the issue. To add a whole new dimension to benefit entitlement based on causes of unemployment might provide new employment for economists but could further interfere with the compensation and benefit purposes of the system.⁴

There is historical evidence that the underlying reason Government enacted unemployment insurance was to protect workers against any kind of unemployment. In one nation after another, capitalism itself was on trial, and social insurance was offered in exchange for workers' acceptance of an economic system that inherently produces unemployment as well as goods and services. The Social Security Act followed many years of industrial change, and when Government at last became committed to unemployment insurance this was in itself proof that politics had caught up with economic fact. The use then of an insurance rationale by Government officials is a better guide to the political climate of the 1920's and 1930's than to the purposes of unemployment compensation itself. In seeking to understand the purposes of UI, it is safer to look to the social processes inherent in industrialization than to the words of spokesmen reacting to a political contingency.

⁴ This can be seen by looking at Warden's policy implications. He suggests there should be two funds in place of the present dual-purpose fund.

"One fund would operate independently of business cycle considerations. Benefits could be keyed to previous income experience and reserved for workers with an attachment to a specific labor force. Experience rating would be used to invoke clear penalty tax rates to discourage unstable individual firm behavior, but the tax rates would not reflect the swing of general business conditions. The other fund would receive constant rate contributions or be financed out of general government revenues, and would be designed to provide benefits at the onset of general business decline. These cyclical benefits could be used to augment other benefit checks, to lengthen the duration of benefit availability, or perhaps to supplement the incomes of some persons not covered by the regular insurance system." (p. 96).

This poses enormous practical obstacles. In addition to present procedures of checking into termination of the worker's employment, his availability for new employment, and his eligibility according to his past work record, it would be necessary to determine which kind of unemployment has occurred. At any given national or regional unemployment rate, there will be unemployment occurring for different reasons.

Of course we are free at any time to reappraise our institutions, but the two recent attempts to make compensation contingent on particular kinds of unemployment have yet to receive a positive appraisal. The Trade Adjustment Act permits benefits contingent on proof that the unemployment is caused by U.S. trade policy. The experience here from labor's point of view has been disappointing, because of the very few persons declared eligible and the miniscule payments made. More to the point is the experience under the extended recession-type benefits provided by the Employment Security Amendments of 1970 and the Emergency Unemployment Compensation Act of 1971, which trigger benefits by statistical measures of unemployment levels. The presumption in these laws is that workers operate in a generalized job market and can find jobs when the unemployment rate is low. The other side of the argument is that at any one time persons may be unemployed for different reasons; and that even with unemployment rates lower than those that trigger extended benefits, there are some individuals who have skills that cannot be matched with job openings within 6 to 9 months. The UI work test has always been applied in terms of "suitable" employment, thereby recognizing particularistic labor markets.

In this short review of the interests of government, employers, and workers in the UI system, there is missing what may become a most important "tension"—the interests of State governments as opposed to those of the Federal Government. In one sense this is not new, as evidenced by the 1959–66 fight over Federal benefit standards in which the Interstate Conference of Employment Security Agencies figured as a most significant lobby in the U.S. Congress against Federal assumption of standards. What is new, however, is the interest in income redistribution as a unique function of Federal policy on the one hand, and the political trend to decentralization of Federal power on the other. To the extent that elimination of poverty is a national economic goal, it will be achieved primarily through Federal policy, because redistribution necessarily requires broadly based systems of taxes and transfer. It does not necessarily follow, however, that programs such as UI, which are structured separately within each State, can or should remain untouched by the redistribution objective. One of the objectives of unemployment insurance, according to its most astute American exponent, I. M. Rubinow, was "the elimination of poverty."⁵ In the pages that follow, it will become clear that UI can fulfill its role of compensating for interrupted earnings much better if there is a clear Federal policy of redistribution through tax reform and income maintenance. In the absence of this, however, adapting UI to a redistribution objective will be a most controversial subject, particularly if States continue to keep the preponderant share of policy control.

In the sections to follow we evaluate the UI program in terms of criteria of interest to the parties, including redistribution. Two aggregate criteria are the wage-loss replacement achieved, and counter-cyclical effects. The attribution of costs continues to be important and controversial. Labor is most interested in the personal wage insurance, that is, the extent to which the worker's standard of living

⁵ I. M. Rubinow, *Social Insurance* (New York: Henry Holt & Co., 1913), p. 481.

is supported. In contrast is the employers' concern with minimizing work disincentives. The extent of variation among the States is an important equity issue. Finally, redistribution will be measured by poverty effectiveness.

Aggregate Wage Loss Replacement

The aggregate wage-loss replacement rate is a rough measure of how much of the burden of unemployment is in fact lifted from the shoulders of the unemployed. It simply estimates what wages and salaries are lost each year by persons looking for employment, and divides this figure into total UI benefits paid during the same period. Of course, some of the unemployed will not be entitled to benefits but their earnings loss is also included in the denominator; coverage, eligibility, and duration limitations as well as the wage insurance rates are assessed by this measure.

It has been estimated that about 18 percent of wage loss during the 1950's was replaced by unemployment insurance and a similar rate appears to hold for the sixties.⁶ We shall see that this replacement rate varies with the business cycle.

There are several reasons for this low replacement rate:

1. *Weekly benefit amount.*—The norm of weekly benefit payments is usually half of the worker's weekly pay (11 States add for dependents), but because of low statewide maximums, many workers receive a smaller fraction. Depending on the State, beneficiaries on the average receive about 30 to 45 percent of their weekly pay loss.

2. *Duration and exhaustion.*—From 20 to 30 percent of beneficiaries use up their benefit weeks before finding employment. These "exhaustees" had been entitled to an average 15 weeks of benefits at worst to an average 28 weeks at best, depending on the State.

3. *Disqualifications.*—For voluntary job terminations or failure to be available or to accept suitable work, persons are denied benefits from a few weeks to the full period of their unemployment.

4. *Eligibility.*—Some applicants are not eligible because they do not have sufficient evidence of attachment to the work force as measured by base-year earnings, weeks worked, or distribution of work during the year. These requirements exclude workers in marginal and irregular employment as well as new entrants and reentrants to the labor market, the latter accounting for a large share of unemployment in recent times.

5. *Delayed filing and nonfiling accounts for some of the uncompensated wage loss.*

6. *Coverage.*—Finally, some persons work in employment that is not covered by the law; no taxes are paid on their behalf and they are

⁶ A study of the period 1948 to 1960 compares benefits paid in those years with estimates of total wage loss incurred. The results varied somewhat depending on whether total unemployment was measured or both total and partial unemployment (where the worker has a short workweek and is receiving a partial UI benefit). For the 13 years, all unemployment insurance programs—State, Federal employees, veterans, railroad, and temporary extensions—compensated 23 percent for total unemployment and 18 percent for total and partial combined. Richard Lester, *The Economics of Unemployment Compensation* (Princeton University, 1962).

not entitled to benefits. In an average month, they constitute about 15 percent of wage and salaried workers.

The low replacement rate is the sum of a partial replacement for some and no replacement for others. For example, in 1967 there were at any time an average of 3 million unemployed but only 1 million were being compensated. The distribution in terms of compensability was as follows:

	Number (millions)	Percent
All unemployed-----	3.0	100
Compensated UI beneficiaries-----	1.0	33
Covered by UI but not compensated-----	.6	22
Eligible unemployed filing for noncom- pensable waiting weeks-----	.2	-----
Disqualified; not filing for benefits-----	.3	-----
Exhausted UI benefits-----	.2	-----
Not covered by UI-----	.4	13
New entrants, reentrants (not eligible)-----	1.0	33

Source: Derived from estimates supplied by the Manpower Administration, U.S. Department of Labor.

One might ask whether, with such a low replacement rate, UI is really worth keeping. Could an income maintenance program easily substitute for UI?

This would be a hasty inference. The total amounts paid annually indicate an actuarial value but do not reflect the security people feel from an insurance program. For instance, the value of life insurance to a family does not await the death of the insured. The UI constituency is not the 5 to 10 million a year who draw benefits; it is the estimated 70 to 75 million workers who work in one or more covered jobs during the year and feel a diminished risk. An income maintenance plan that paid \$7.5 billion a year (UI payments in the recession year of 1971), would not be regarded as a fair trade.

There is also the fact that UI is regarded as still unfinished business. Coverage has been significantly improved in recent years. Maximums expressed as a percentage of average weekly wages are becoming more prevalent and will help resist the erosion experienced in inflationary times.

Counter-Cyclical Effects

The wage-loss replacement rate is not a constant, but varies with general business conditions. The reasons are complex. Looking first at the early stages of a recession, two things happen: There are likely to be higher wage earners among the insured unemployed and because of the restrictions of the maximum they will receive a smaller proportional replacement of their wage loss. But, at the same time, the portion of the total unemployed who will qualify for benefits is increasing. The evidence is that the first effect is overshadowed by the second and that in the early stages the overall replacement rate is higher than it was before the downturn.

In the later stages of a recession, the total replacement rate drops considerably, more than unemployment figures would suggest, because an increasing number of persons exhaust their benefits.

We noted that in the fifties the replacement rate averaged about 18 percent, but the swing was about 8 percentage points on each side of this figure. In the economic boom period of 1955 there was a replacement rate of only 15 percent, but at the high point of the recession of 1958 it was 31 percent, and then fell again.

Several studies by economists interested in countercyclical effects argue that UI is not sufficiently sensitive to the cycles. Lester used his data to argue for amendments that would make benefits more responsive to recession conditions.⁷ A study of the Massachusetts experience estimates that only one-third of total payments were occasioned by cyclically caused unemployment.⁸ Some of the interest in triggered extensions is prompted by the wish to enhance macro-economic effects.

The role of unemployment insurance as an instrument for economic stability is an important matter that has not yet been resolved. Here we must also raise the question whether UI is greatly superior as a stabilizer to income maintenance alternatives.

A complete model would take account of benefit payments and tax contributions, and the net inflow or outflow of funds. It would also have to provide for the incidence of the tax and spending patterns of beneficiaries. These are difficult questions. If we assume some of the tax incidence falls on profits because of the effects of the experience rates, and that most benefits are spent on current goods and services, then even a balance between contributions and expenditures will result in some shift from investment to consumption. The model should also account for the investment of reserve funds, which has the effect of returning money to private hands.

The magnitudes are not large, however, total benefits being less than 1 percent of disposable income except in recession periods. A study that simulated a recession situation concluded that even if UI provided benefits at a level 50 percent higher than it actually does, it would have little effect on GNP changes from peak to trough.⁹

However, this does not distinguish between the role of UI at the beginning of a recession and its role during the upturn. Here the evidence seems that during the downturn UI provides over half the effectiveness of all stabilizers. The increase in benefit payments during the downswing has been estimated to be 28 percent of the decline in national income, compared with a combined impact for all stabilizers of 51 percent.¹⁰ Since UI contributions appear to be

⁷ See Richard Lester, *The Economics of Unemployment Compensation* (Princeton University, 1962).

⁸ Warden, Jr., op. cit.

⁹ J. S. Duesenberry, O. Eckstein, and G. Fromm, "A Simulation of the United States Economy in a Recession," *Econometrica*, XXVIII (October 1960), pp. 740-809.

¹⁰ M. O. Clement, "The Quantitative Impact of Automatic Stabilizers," *Review of Economics and Statistics*, XLII (February 1960), pp. 56-61.
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rather stable, most of this influence of UI derives from the rapid expansion in benefit payments. Although this effect on the downturn is impressive, UI seems to have little dampening effect during the upturn.

An income maintenance program that was financed primarily through the Federal income tax would have an anticyclical effect on the tax side. An income-tested plan, unlike a demogrant or tax credit scheme, would also provide larger expenditures during a recession when incomes were down, although, of course, benefits under any type of plan can be adjusted during recessions and upswings.

Although the influence of UI at the early stages of a recession is important, it is difficult to argue strongly for its stabilizing function as against that of alternative income maintenance plans since all have some anticyclical effects.

Both UI and income-tested plans have the additional merit of paying money directly to those affected by recession.¹¹ UI does this particularly well, paying quickly when, where, and as layoff occurs, except to marginal workers and those only recently employed. The effectiveness of an income-tested plan in this regard would depend on the accounting and payment period, as well as the definition of income, but short accounting periods are preferable for wage replacement.

Allocating Costs

An early exponent of experience rating in UI stated that "The social and human costs of irregular employment should properly be charged against and compensated by each employing unit. Only in this way can consumers be assured that a low price is not a misleading and parasitic price, and that the competitive system is really functioning in the public interest."¹²

The purest application of this principle would have every employer make contributions to the fund that exactly matched total benefit payments to his (former) employees for whatever portion of their unemployment is directly attributable to his company. Over a period of years a benefit/tax ratio of unity for every employer in the State would be equivalent to perfect experience rating. (As used in this section, "tax rate" refers to the rate at which employers pay into the UI trust fund, calculated as a percentage of total payroll.) A distribution above and below unity would indicate departure from experience rating and the amount of subsidy from some employments to others.

¹¹ It is worth noting that there are indicators of impending business downturn that appear earlier than the beginning of layoffs. To be most effective, anti-cyclical monetary and fiscal policy should be geared to such indicators.

¹² Paul A. Raushenbush, "The Wisconsin Idea: Unemployment Reserves," *Annals of the American Academy of Political and Social Science*, vol. 170 (November 1933), pp. 72-73.

All States consider a firm's experience as one consideration in setting employer tax rates but all fall short of pure experience rating.¹³

Data are not available to study the distributions of all States' benefit/tax ratios. From various proxy measures, however, it is possible to make inferences. It seems likely that Wisconsin, Florida, and Ohio vigorously apply experience rating in contrast to Idaho, Washington, and Oregon. These States are at opposite ends of a continuum. We can also infer that the reserve-ratio system of experience rating is more vigorous than other systems.

But it is also clear that no plan goes the whole way. For example, Wisconsin has a high maximum employer tax rate. But in 1967, the benefit-tax ratio of firms with negative balances averaged 1.7, which means these firms would have had to pay taxes 70 percent higher to cover their benefit costs. This is an average, and under pure experience rating half these negative balance firms would pay still more. It would appear that a pure experience rating system would require very high rates indeed, so high that small firms which are particularly subject to wide variation simply could not take the risk. (A firm of two employees that has to pay 26 weeks of benefits to a former employee would find itself facing a 12.5 percent tax on total payrolls in a 1 year recoupment.)

There are economists who argue for pure efficiency allocation, on the grounds that seasonal employers would be stimulated to use more

¹³ "Experience rating" in unemployment insurance is only a general principle and there are many variables for designing a plan. The essentials can be suggested by showing "tax rates" for the firm as a function of the "quantity of unemployment." In theory, a linear correlation could be established, as in fig. 1, and each employer would fall somewhere on the line. However, different States define



FIGURE 1.—Tax rates as a function of unemployment in the firm under "pure" experience rating.

"quantity of unemployment" in different ways. Some put the emphasis on paper accounts for each employer that balance their past tax receipts and charges; others emphasize benefit payments; others the number of individuals laid off without regard to how much they have drawn in benefits; and some plans look only to variation in payrolls.

Similarly, the vertical axis has a different meaning in different States. The tax rates apply to varying amounts of an employee's annual wages.

In addition, States have shown a different approach to minimum rates, maximum rates, and to the rate increments that operate in between. Thus, the same firm could face a different set of cost curves depending on which State it was located in, as in fig. 2.

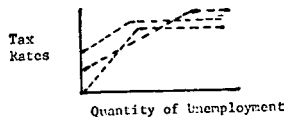


FIGURE 2.—Example of styles of tax schedules facing similar companies in different States.

Finally, there are different approaches to changing the tax rates as the trust fund rises and falls. Some States change the shape of the rate schedules, others try to retain the pattern. In terms of fig. 2, some States adjust for dropping fund levels by moving the intercept to the right, others move it down, and some do both in differing degrees.

capital or reduce seasonality, and marginal employers would be forced out of business. Says one, "An experience rating system without a tax ceiling, requiring employers to cover all the benefits to employees, would increase employees' effective annual income—earned wages plus benefits—and redistribute wages over the year, with no interfirm subsidy."¹⁴

Several concerns have restrained this extreme approach. First it is not acceptable to have an employer tax that is allowed to vary so much it can destroy a business. Tax ceilings in effect serve to cushion employers against the economic risks of having to shoulder the full social cost of unemployment produced by their firm. In this sense, imperfect experience rating plans serve as a kind of business survival cushion, without which employers might have to buy insurance to protect themselves against a high tax rate. Secondly, it is not always clear when these high cost rates are predictable and when they are not. It is only clear at the extreme: where weather or nature is a decisive factor, then UI benefits do subsidize wages. (There is almost unanimous agreement about the difficulties of UI in this area.) The picture rapidly gets murky, however, as one attempts to expand the number of "seasonal" activities to all those affected by varying annual demand. Further analysis awaits time series data on the range of cost rates of individual firms within the questionable industries.

A change that would allow some adjustment for the seasonality problem is industry experience rating. At present this is prevented by Federal law which holds that the only experience rating system permitted a State is one where the tax is adjusted to each employer's own experience. Under industry experience rating, seasonal employers could pool or average their experience thereby dampening out extremes without being subsidized by other industries.

An important question in UI is whether experience rating has program effects as well as allocation effects. A fear that this is so is the third explanation for the reluctance of some States to go deeper with experience rating. Because employers have a major role in claims administration and in benefit policymaking, too drastic a tax bite can adversely affect payments. There is evidence already that this is the case, causing the income maintenance purposes to be compromised by the financing method.

In his forthcoming study of experience rating, Joseph Becker reports from his surveys of referees and State UI directors that experience rating does indeed have an effect on administration and policymaking.¹⁵ He believes this effect is desirable.

My own experience leads me to a different conclusion; namely, that experience rating gives private interests priority over the public purpose of the program. I have observed State legislative committees deliberating UI policy with employer representatives sitting at the table with legislators while labor representatives were confined to the audience. I suspect that a great deal more time is spent arguing over who shall pay taxes than over the standards of benefit adequacy. This is certainly the balance in the UI literature. There are enough byways

¹⁴ Warden, Jr., op. cit.

¹⁵ *Experience Rating in Unemployment Insurance* (Johns Hopkins Press, forthcoming). Excerpts from this study are to appear in Joseph Becker, *Experience Rating in Unemployment Insurance* (W. E. Upjohn Institute for Employment Research, Washington, D.C., 1973).

in experience rating to challenge the best brains, but it is not always clear that the motivation is so much better than that of Sheridan's man Fox: "I would," said Fox, "a tax devise, that shall not on me fall."

In claims administration, experience rating stimulates the employer to send experts: at stake is next year's tax rate. Employers who contest benefit applications can do so by a variety of means. In Ohio, a State that has a relatively effective form of experience rating, employers hire actuarial and service organizations to contest claims, and these firms are paid on the basis of their "success." An employer may prefer to send his attorney or personnel manager. The claimant can bring in help if he needs it, but attorneys are not attracted to this practice because of the small amounts involved. A union representative may assist in some cases, but most employees have no representation in appeals hearings. For these reasons, it is a mistake to presume that there is an equal contest or that there exists a climate for fair and impartial administration.

In their review of the history of unemployment compensation, Haber and Murray have concluded with this assessment of the various effects of experience rating:¹⁶

Experience rating of employer unemployment taxes as it has developed in the states, has had a major influence on their unemployment insurance programs. Paradoxically, it has had only limited influence in stimulating the stabilization of employment, the primary reason for its introduction into the program. The second objective of experience rating, the allocation of the costs of the program on the basis of the risk of unemployment, has been more nearly achieved since unstable industries have borne a greater share of the cost of benefits than stable industries. Experience rating, however, has hampered any shifting of the cost on to the consumer, a result which many originally anticipated. In addition a disproportionate share of the cost of the program has been borne by new employers who have not yet qualified for experience rating. A third objective of experience rating, employer participation in the program, has received increasing attention. This has taken both the form of "policing" the system against unwarranted payment of benefits and of employer influence on legislation. "Policing" the system has sometimes been overzealous, but no doubt has kept down abuse of the system. The savings in benefits, however, have been small compared to the large amounts in taxes that employers have saved through experience rating. Employer influence on legislation has been stimulated by experience rating, and has usually been in the form of opposition to liberalizations in benefits and support of restrictive disqualification provisions. At times, employers have joined with labor in proposing benefit increases. However, this has often been in return for labor's agreements to tax reductions. Pressures to keep taxes low have resulted in underfinancing in some states.

Supporting the Standard of Living of the Involuntarily Unemployed

Inherent in the benefit principles of UI is the theory of the declining marginal utility of income. Total utility for the wage earner can be raised by smoothing out his income over all the weeks of the year, rather than receiving more in some weeks and none in others. Since this would argue for weekly benefits equal to weekly wage loss, it is constrained by another principle, that of preserving work incentives. Replacement for a limited period of time is partial in order to encourage the search and acceptance of work.

When UI plans were enacted, it was not clear at what level replacement began to impair incentives (we still do not know). It was as-

¹⁶ William Haber and Merrill G. Murray, *Unemployment Insurance in the American Economy* (Homewood, Ill.: Richard D. Irwin, Inc., 1966), pp. 356-57.

sumed to be some proportion of one's weekly wage, and an arbitrary judgment was made that benefits should replace about half of one's weekly wage loss. (This was less than the two-thirds replacement principle in workmen's compensation where more objective standards were available to detect malingering.)

This decision was different in conception from that used in England. Sir William Beveridge had said that, "Social insurance should aim at guaranteeing the minimum income needed for subsistence."¹⁷ Though we adopted some features of British social insurance, we rejected the subsistence concept. It was felt that the existence of unemployment as a normal feature of free enterprise required recognition that the workers' loss was the important thing, and that the loss was their wage. Since most lived exclusively on their own wages, their previous wages are the foundation of their standard of living. Payment of benefits in an adequate proportion to wage loss helps maintain this standard until workers regain their normal employment status. Since there is a wide difference in wage levels and living standards among regions of the country, a wage-determined benefit also provided an automatic adjustment for regional variation.

What is the evidence as to how well UI has succeeded in maintaining its beneficiaries' standards of living? A series of studies in 1954-58 and one more recently have responded to this question by comparing benefits with the claimant's previous wages, family income, and family expenditures.¹⁸

For most beneficiaries, weekly benefits were less than half of their former gross weekly earnings and in many cases less than half their take-home pay. The ratio of benefits to earnings (wage-loss replacement) was lower for heads of families than for single persons. This was because of the higher earnings of family heads who were more likely to be affected by State maximums. In wage-loss replacement, single persons fared better than men in families who were the sole or principal earner. And because of their low-wage levels, women in families fared best of all.

Unless there was more than one earner, beneficiary families received little income from sources other than UI. In the families of beneficiaries who were the sole or major earner, and in single-person households, cash income during unemployment was less than half of the level of cash income during the beneficiaries' employment. Multi-earner families in which the beneficiary was not the principal earner did not of course experience as much of a drop in family income during employment.

What about benefits relative to expenditures? First we should note that families with unemployed wage earners did not reduce their expenditures commensurately with their drop in income. A large proportion of families maintained expenditures considerably above income by using up savings, borrowing, and receiving help from family

¹⁷ Sir William Beveridge, *Social Insurance and Allied Services* (New York: The Macmillan Co., 1942), p. 14.

¹⁸ Beneficiary surveys conducted by State agencies in cooperation with the U.S. Bureau of Employment Security, reported in *Unemployment Insurance and the Family Finances of the Unemployed* (Washington, D.C.: Government Printing Office, 1961), U.S. Bureau of Employment Security, BES No. U-203.

or friends. The reductions in expenditures were somewhat higher in recession periods.¹⁹ Benefits appeared to range from 38 to 48 percent of cash expenditures, depending on the State.

By postulating a list of nondeferrable expenditures (food, shelter, utilities, medical care), a test of adequacy of UI payments is whether they are sufficient for these necessary expenditures. UI benefits in surveyed families covered only one-half to three-quarters of such expenditures by families whose head was unemployed. For single beneficiaries, the ratio of benefits to nondeferrable expenditures was more nearly 1 to 1.

In summary, the evidence of these surveys cuts several ways depending on who is unemployed. First, it shows that UI weekly benefits are not sufficient for families in which the beneficiary is the sole or principal earner. They are, therefore, required to use other means to bridge the gap between income and nondeferrable expenditures. The problem could be remedied by raising maximums so that middle-income workers would also benefit from the half-of-wages replacement principle. More extensive use of dependents' allowances would also help here. For single workers, the program seems to work about as intended as an economic security system. For additional earners in the family other than the principal earner, it is difficult to evaluate the role of UI without more data about how their earnings figure in family finances.

The duration of unemployment is a factor affecting the adequacy of benefits, in part because the deferrability of some expenditures diminishes in time and because benefits are eventually terminated. A study in the recession of 1958,²⁰ showed that families of the unemployed decreased savings, postponed buying, borrowed money, piled up bills and got help from relatives in varying degrees depending on how long they had been unemployed. The most striking finding, however, was that as duration of unemployment went beyond 13 weeks and then beyond 27 weeks, there were drastic adjustments made, such as moving to cheaper quarters, other family members getting jobs, and going on relief. It can be inferred that termination of weekly benefits signals the need for drastic adjustments.

Work Disincentives

There is, then, considerable evidence to suggest that UI does not fully meet its economic security goals of supporting standards of living of the involuntarily unemployed. Is there evidence that benefits interfere with market incentives?

A valuable but frequently overlooked study by Lininger published in 1963,²¹ investigates whether the size of the weekly benefit amount affects the length of time individuals draw benefits. The method of study was to control for different labor demand factors associated with

¹⁹ This may reflect pessimism about reemployment opportunities, as well as that some were unemployed for longer periods and made more adjustments. Also, more sole or principal wage earners are unemployed in recession times, resulting in heavier income loss.

²⁰ W. J. Cohen, William Haber, and Eva Mueller, *The Impact of Unemployment in the 1958 Recession* (Ann Arbor: Institute of Labor and Industrial Relations, University of Michigan and Wayne State University, 1960), p. 40.

²¹ Charles A. Lininger, Jr., *Unemployment Benefits and Duration*, Institute for Social Research (Ann Arbor: The University of Michigan, 1962).

occupation and industry, length of employment, education, age, sex, race, and place of residence. With variation in duration from these factors accounted for, the remaining variation was assumed to be attributable to differences in the ratio of weekly benefits to the worker's previous wage. The absence of any correlation with the duration of the claims showed workers did not postpone employment because of the benefit-wage ratio. The author concluded that, "an increase in the size of weekly unemployment benefits would not lead to longer duration of such benefits."

Another study²² of State data for the years 1962 and 1967 shows a small effect of benefits on the duration of claims. This study, by Chapin, estimates that an increase in the level of benefits relative to wages by 10 percent would have increased the average duration of benefits in 1967 by 1 day.²³

A recent study of "partial benefit" schedules—situations in which UI claimants may work and receive reduced UI benefits—shows that certain kinds of schedules (where work increases result in a net loss of income from work and benefits combined) do restrain work effort to earnings below the critical points of the schedule, thus adversely affecting work behavior.²⁴

Studies of exhaustees in several States are inconclusive as to whether there is prolongation of unemployment as a result of UI benefits.²⁵ As might be expected, some persons who terminate their benefits continue to be unemployed, some get work, some withdraw from any further search. The question is whether the rates of withdrawal or reemployment jump suddenly with the termination of benefits; a logical inference is that benefits had delayed the return to work.²⁶ But it is not clear that this immediate jump is excessive given the purpose of UI to provide support until there is "suitable" employment.

Other studies have been made on disqualifications and availability criteria, but are somewhat dated. There is room for more empirical work on the wage and mobility effects of UI. From the evidence available, however, there is little reason for fear that UI is severely distorting the operation of the labor market. The exception to this is in certain seasonal employment where labor is attracted by the combination of wage and UI benefits. As for women workers, it is often concluded that they are a special problem for UI because working wives as so-called secondary wage earners have less work attach-

²² See Gene Chapin, "Unemployment Insurance, Job Search, and the Demand for Leisure," *Western Economic Journal* (1971) pp. 102-107.

²³ Chapin's model also shows that the legal maximum duration of UI benefits affects the average duration of unemployment. But since about one-fifth of claimants exhaust their benefits and since average duration of unemployment is compensated unemployment, the finding is a truism with no implication for the effect of UI on work behavior. Chapin appears to recognize this but does not say so explicitly.

²⁴ See Raymond Munts, "Partial Benefit Schedules in Unemployment Insurance: Their Effect on Work Incentive," *The Journal of Human Resources*, vol. V, No. 2 (1970).

²⁵ See U.S. Department of Labor, Bureau of Employment Security, *Major Findings of the 16 State Studies of Claimants Exhausting Unemployment Benefit Rights, 1956-59* (Washington, D.C.: Government Printing Office, 1961).

²⁶ The analytical tool here is "survival rate" which is the proportion of claimants one week who are still unemployed and available for work the next week. (Survival rate is one minus the reemployment and withdrawal rate.) The survival rates suggested by the postexhaustion studies appear to fall within the range of the survival rates for beneficiaries. Further study is needed, however, because survival rates vary by State and the stage of the business cycle.

ment. However, labor force participation of women is changing rapidly. Too frequently, conclusions about "women workers" in UI do not distinguish the effects of low earnings and occupational differences which also are associated with female employment.

It would indeed be surprising if UI did not in fact prolong unemployment to some extent. Not only would this be contrary to economic theory, but it would negate what some regard as one of the purposes of UI; namely, to allow unemployed workers to take time to find suitable jobs that make use of their skills and experience. In any final assessment of UI's effect on economic efficiency, some allowance must be made for this contribution to employment stability and productivity.

Benefit Inequities Through Interstate Variation

Originally State UI plans were very similar to each other, largely because of their lack of expertise and their acceptance of the recommendations of the Social Security Board. With experience came innovation, and now there is considerable variation. The differences have also been accelerated by such considerations as the varying cost of UI because of different unemployment rates among the States; competitive pressures among the States for industrial development; and the relative strengths of labor and management in policymaking.

The maximum weekly benefit excluding dependent allowances ranges from \$45 in Indiana to \$105 in the District of Columbia. Potential duration of benefits (number of weeks allowed) ranges from an average potential of 30.6 weeks in the District of Columbia to 19.8 in Florida. Minimum benefits, total annual benefits, eligibility conditions, disqualification rules all vary considerably. The result is that similar kinds of workers will be treated differently depending on where they live. An unemployed worker (with no dependents), earning the national average weekly wage (\$141 in 1970), would receive weekly benefits of as little as \$40 or as much as \$77 depending on the State in which he had worked. His benefit would have been equal to 30 percent of his average weekly wage in one State, 30 to 39 percent of his average weekly wage in 12 States, 40 to 49 percent in 25 States, and 50 percent or more in 14 States.

To some extent weekly benefit levels and the duration of benefits are trade-offs, in the sense that one State can have higher weekly benefits and shorter duration than another and yet both give beneficiaries about equal total benefit entitlement. Another trade-off is between liberal benefits and tight eligibility and disqualification rules as against low benefits and easy rules.

The cost rate of a State program is one indicator that sums up the liberality of all benefit dimensions considered together. When we further refine the cost rate by estimating it for equal levels of State unemployment (through actuarial procedures), we have a pure measure of how generous a State is toward its unemployed workers.²⁷ (This can be expressed as statewide benefit expenditures per \$100 of total covered payrolls if covered unemployment in the State had averaged

²⁷ For the methodology, see Raymond Munts, "A Useful Quantitative Measure of State Unemployment Insurance Benefits," discussion paper No. 36, Institute for Research on Poverty (The University of Wisconsin, 1969).

3.5 percent during the year.) The figures for the range in 1960 and 1967 are given below:

Range of UI cost rates¹ for 3.5 percent unemployment rates

	Low State	High State	Low/High (percent)
1960:			
All States.....	\$0. 70	\$1. 40	50
Continental States only.....	. 74	1. 40	53
1967:			
All States.....	. 71	1. 60	44
Continental States only.....	. 75	1. 44	52

¹ Cost rates are usually expressed per \$1 of covered payrolls; here they are stated per \$100 for easier interpretation.

The conclusion is that some States are twice as generous as others and that during the first 7 years of the 1960's there was little change in the amount of interstate inequity.

Redistributing Income

It is a mistake to think of UI as purely wage related. Four kinds of compromises have been made with the concept of a social minimal income on the grounds that there is a greater "presumed need" in certain cases.

(1) The maximums set a statewide ceiling which prevents the half-of-wage loss principle from operating for the higher earners. They must expect weekly benefits at less than half of their own wage loss and the exact amount depends on where the statewide maximum has been set. Presumably this is a concession to the idea that such workers have more savings and other resources to fall back on, and therefore need less than half of their wage loss replaced. (Were this principle rigorously observed, we would find a great deal more consistency in maximum benefit amounts relative to statewide average wages than in fact exists.)

(2) Nine States compromise the half-of-wages principle so that lower paid workers get a larger share than this. The State that has carried this the furthest gives the lowest paid workers a benefit of 68 percent of their weekly wage loss.

(3) Eleven States adjust the benefit amount according to family size, or at least add small payments for a specified number of dependents.

(4) Eight States and Puerto Rico with uniform duration of benefits allow lower income persons to receive the same number of potential weeks of benefits as higher income persons. The other States with benefits of variable duration scale down the number of potential weeks for those of lower earnings or intermittent work records. The effect is that in the uniform duration States, persons with low earnings in their base year can draw higher total annual benefits than comparable persons in the variable duration States.

With this evidence from the benefit structure, one can presume there is some amount of income redistribution going on within the UI

program. But how much? The best source of information comes from the Survey of Economic Opportunity (SEO) of 1967.²⁸ Although there was substantial underreporting of UI, the SEO is suggestive about the extent of redistribution occurring through UI. The following paragraphs summarize some of the results.

Of the total of all payments reported, 20.4 percent were paid to poor recipient households. Of all the households receiving UI payments, 15.9 percent were poor. These are the best available estimates of the antipoverty effectiveness of the UI program.

The average payment to all families receiving UI in 1967 was \$400 and the average to poor families among these was \$513 suggesting somewhat more poverty sensitivity than the wage-qualifying requirements and wage-related benefit structure of UI would lead one to suppose. The explanation lies in the compromises with the needs concepts described above and also the probability that the poorer families were out of work for longer periods.

The \$513 average payment was 43 percent of the average poverty gap of the recipient poor families, suggesting wide room for income support in addition to UI. Of the 459,000 poor families receiving UI, about 132,000 (29 percent) were taken out of poverty by their UI benefits. (The other 61 percent would all be eligible for benefits from a guaranteed minimum income plan designed to close the poverty gap.)

UI's insensitivity to family size (only 11 States vary benefits by family size) appears in the finding that benefits did not increase with family size. Single and small families even did substantially better than seven- and 8-person families. The percentage of the poverty gap filled by UI varied from 83 percent for single-person households to 13 percent for 8-person households.

Benefits were highest (over \$800) where the head did not work at all during the year, and declined steadily as claimants worked more and more weeks during the year. This was true for all recipient families as well as for poor recipient families.

The year 1966 was a year of relatively low unemployment. It would be informative to know the redistribution impact of UI in a year with a higher rate of unemployment. On the one hand, persons of higher income would be out of work and receiving UI in such a year; on the other hand, wage earners would have smaller total earnings for the year. The former effect would reduce UI's poverty effectiveness; the latter effect would increase it. Without information comparable to that provided by the SEO, we cannot know which would be the dominating influence.

²⁸ The Survey of Economic Opportunity was conducted for the Office of Economic Opportunity in the spring of 1967 and applied to 1966 income of the respondents. The sample of 30,000 households, or addresses, consists of two parts. The first part is a national self-weighting sample of approximately 18,000 households, drawn in the same way as the Current Population Survey sample. In order to obtain better information concerning the poor, particularly the nonwhite poor, 12,000 additional households were also included in the survey by drawing a sample from areas with large nonwhite populations. Questions were asked about various kinds of income including unemployment insurance. The survey respondents reported a total that was 62.8 percent of all UI program expenditures in 1966. This underreporting is felt by some UI experts to be too serious to warrant use of the SEO data. The findings reported here are from an analysis prepared by Ben Gillingham, "Cash Transfers: How Much Do They Help the Poor," Institute for Research on Poverty, University of Wisconsin, January 1971.

Desirable Changes in UI

There are two possible types of adjustment that at first would appear to make UI more sensitive to low-income workers but which for different reasons have to be rejected.

First, why not raise the minimums? This has been given considerable attention in old age and survivors insurance but there are more severe constraints in UI. The minimums range from \$5 to \$25 depending on the State. But if the \$25 minimum means a requirement of \$50 a week in earnings over a quarter in order to qualify for any benefits, then the consequence of raising minimums in most cases would be to prevent lower paid or irregularly employed persons from drawing any benefits, which they would have had if the State minimum were lower. As long as the benefits are set as a fraction of earnings, a low minimum is partially a liberal provision because wage qualifying requirements are low. The minimum is simply the border at which the wage qualifying requirement is met and translates into a benefit. To the extent a minimum is set above zero it is in effect a denial of eligibility on grounds of insufficient earnings alone.

In this economy, many wage levels are themselves already too low for subsistence, and a subsistence minimum cannot be reconciled with partial wage replacement. It is here that a new plan of income maintenance—either a wage subsidy or demogrant or negative tax plan—is required.

Second, is a longer accounting or payment period possible? In UI the accounting period is usually some combination of year and quarter, while the payment period is always 1 week.²⁹ Annual or quarterly accounting periods are frequently recommended for income-tested plans, but the payment periods are also thought of on annual, quarterly or monthly bases. In general the thrust of thinking in income maintenance is to emphasize the equities that flow from longer periods. When applied to UI, for example, it may be right to question why higher weekly benefits should be paid to a carpenter than to a hospital worker, since the former may make more annually, even omitting winter weeks, than the latter working year around.

Although many equity questions can be raised about UI, the controlling consideration appears to be the desire to retain the concept of wage replacement (as opposed to annual income supplement) and to pay as wages are paid. Given the long history of wage reform—the efforts to have wages paid regularly on a weekly or bimonthly basis—it would appear retrogressive for a wage replacement program to use longer pay periods.

²⁹ Most States average earnings over a good (high) earnings quarter in order to compute the weekly benefit, but five States average wages over the year. In these five States the weekly benefits average out lower than most States, in part because weeks of no work are included in the averaging. The annual benefit formula operates to the disadvantage of irregular workers (both high and low paid) as against steady workers, and are retained by the States that have them in part as one response to the seasonal problem. There is, of course, no reason the average weekly benefit has to be lower than in other States since weekly benefits could be set as a higher percentage of annual earnings than is now done under the annual formulas. The main reason this approach has not been more widely accepted is because it departs from a close relationship that is desired between benefits and living standards of workers when they are employed, for which full-time earnings are the better measure.

However, there is a tax adjustment that would introduce more equity into the picture from an annual income viewpoint. At present UI benefits are not taxable as income under the Internal Revenue Code. Hence, two workers are treated differently if they have the same annual income, in one case from earnings and UI benefits and in the other case all from earnings. The only argument against taxing UI benefits has been that these benefits are already insufficient in their function of supporting standards of living, and that taxing benefits would make a bad situation worse. However, this objection would disappear if UI were amended to fulfill its intended role.

There are many kinds of changes that could be made in the UI program, as even the most cursory review of standard works in the field will indicate. My personal suggestions below are intended to be consistent with the background of the purposes of UI as sketched above:

(1) Raise maximums until only that 20 percent of insured workers with the highest earnings will be eligible for the maximum, thereby allowing 80 percent of insured workers a benefit of at least half their weekly wage loss. This proposal restores the wage insurance principle to its original strength.

(2) Weight the individual earnings formula so that lower income persons can receive more than half their weekly wage loss, perhaps up to 70 percent of gross wages for the lowest earners. This leaves a small gap from take-home pay for large families and verges on conflict with market incentives, but allows clear gains in meeting the redistribution objective.

(3) Pay additional benefits to those with dependents. These should be flat additional amounts per dependent rather than special schedules for family size, in order to clearly distinguish wage-related benefits from dependent benefits. This distinction should allow easy repeal of dependents' benefits should an income maintenance plan sensitive to family size be enacted. To avoid compounding with the weighted formula of (2) above, the combination of (2) and (3) could be limited to 85 percent of take-home pay.

(4) Establish uniform duration for all claimants of 39 or 52 weeks, if no general income maintenance program is adopted, and up to 26 weeks if one is adopted. In any case there should be special application of manpower services after 26 weeks unless general recession conditions prevail.

(5) Eliminate penalty disqualifications of such severity as "duration of unemployment" and instead specifying a limited number of weeks of no benefits.

(6) Construct "partial benefit" schedules for those with earnings who also qualify for UI in such a way as to encourage work effort. Some compromise between providing work incentives and raising the benefit (as a percentage of previous wage) would clearly be necessary to avoid situations in which the combination of UI partial benefits and current wages too closely approached past wages.

All of the above would probably have to be done through federally established benefit standards. In addition, Congress could move on several other matters:

(7) Pay benefits to new entrants. This would be financed from general revenues by reimbursing the trust funds, much as with Government employees and veterans.

(8) Finance the employment service and other manpower services from general revenues. Payroll taxes are regressive and inappropriate for such Government services, and this change will aid the redistribution objective.

(9) Count UI benefits as taxable income for purposes of the Federal income tax.

(10) Extend coverage to farm employees, domestics, and employees of local government.

In the table below is indicated whether these recommendations work in a positive or negative direction for various objectives and the relative strength of the effect, measured on a scale from +3 to -3.

	Raising maximums	Weighted benefit formula	Depend- ents' allowance	Uniform duration	Limited penalty denials	"Incentive" partial schedules	Benefits for new entrants	Shift employment service to general revenues financing	Make UI benefits taxable	Extend coverage
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Higher aggregate wage-loss replacement.....	+3	+1	+2	+2	+1					+1
Higher countercyclical effect.....	+2	+1	+2	+2	+1					+1
Minimize program effects of experience rating..	+2	+1	+1	+1	+1		+1			
Support standards of living.....	+3	+2	+2	+2	+1		+1		-1	+1
Diminish interstate inequities.....	+2	+2	+2	+3						
Strengthen work incentives.....	-1	-1	-1	-1	-1	+1				
Redistribute income.....	-2	+3	+3	+2	+1		+2	+3	+1	+1

PART II. ROADS TO INCOME MAINTENANCE

Income Maintenance Plans as Substitutes for UI

TYPES OF INCOME MAINTENANCE PLANS

We shall distinguish between two broad classes of income maintenance plans, those that are directly "income tested" and those that are not (now being called "demogrants"). A plan that is income tested is designed to close the gap between a family's actual income and a specified level, called the guarantee, which is deemed to be the minimum standard for a family. An income-tested plan is sensitive to all sources and amounts of income received by the family and adjusts the guarantee accordingly. Income of all kinds, including social insurance benefits, is subtracted in whole or part from the guarantee to decide the actual payment. Examples of income-tested plans are public assistance, negative tax plans, welfare-oriented plans and the family assistance plan (FAP) considered by the 92d Congress.

Demogrants are usually thought of as flat payments or credits to persons who are broadly described in demographic terms, as, for example, childrens' allowances. A pension plan that pays the same to every individual 65 or over would be a demogrant. In such cases there is no inquiry into the amount of sources of other income.

It has been pointed out that there are examples of demogrants in the history of Federal income tax law. Rolph has revived this by proposing that income tax credits be given according to family size.³⁰ This would be in lieu of the exemptions now allowed. The present exemptions have lower value for lower income persons, both because such families may have no tax payable and because of the progressive tax rates. Under the Rolph proposal, if the credit is greater than the total tax owed, the family then will receive a payment. The credit income tax thus becomes a part of the system of tax transfers, along with social security and other programs. It was a variant of this idea that Senator McGovern in his 1972 campaign for the presidency first considered, then reconsidered.

Although the transfer side of a demogrant does not vary if the family has other sources of income, the recipient is not immune on the tax side, because taxes must be raised to provide the revenue necessary to finance the demogrants. Whether the tax is proportional or progressive in its structure, disposable income will vary with the income level of the family receiving a demogrant because of the tax. The value of the demogrant for higher income persons will be partly or wholly offset by the increase in taxes over what they now pay. Beyond a certain income level, most families will be net losers.

Thus, the essential difference between an income-tested plan and a demogrant is that the former subtracts some percentage of family income from the transfer, but the latter does not; but both—if they are financed by the Federal income tax—consider income in varying the amount of tax due.

The advantages claimed for the demogrant are of two kinds. First there is no need administratively to look into the private affairs of

³⁰ Earl R. Rolph, "A Credit Income Tax," *Industrial Relations*, VI, No. 2 (February 1967), pp. 155-165, reprinted in T. R. Marmor, *Poverty Policy* (Chicago: Aldine-Atherton, 1972), pp. 207-217.

the recipient, except as now done through the income tax. Second, the treatment of earnings under the demogrant is more likely to be in accordance with incentive principles, at least for lower income persons. For instance, in the discussions of the family assistance plan, the argument turned on whether the payments should be reduced by 50 cents per dollar of earnings or by 67 cents. Under a demogrant, the tax on earnings for the comparable income group would be considerably lower than this.³¹ For a fuller description of these plans the reader is referred to the introduction to this volume.

ECLIPSE OF UI BY INCOME-TESTED PLANS

Where an unemployed worker would be entitled to UI benefits and also to payments from an income-tested plan, there may be cases where there is no advantage from obtaining UI benefits. This would be the case if UI benefits were totally subtracted from the potential payment level in setting the actual payment, and UI benefits in a particular case were less than the potential payment. If this occurs to a majority of the UI constituency, they will lose interest in UI because they get as much or more from the income-tested plan. In effect, UI will have been eclipsed. This can happen even under rather modest guarantee levels and does occur now in some instances. Some AFDC recipients, for example, receive AFDC supplementation of UI benefits.

To illustrate, it will help to use a specific situation, such as the family assistance plan (92d Cong.) and the UI program of Mississippi. In the family assistance plan the period for calculating payments was the three previous quarters with carryovers from each to the succeeding quarter. We simplify by assuming there are no earlier carryovers and that there is no income in the previous quarter except earnings. Earnings of the previous quarter become the relevant variable. Similarly on the UI side we assume that the base year ended with the date of applications for benefits,³² and that the high quarter for benefit determination was also the previous quarter. These assumptions are simplifying only and do not distort what we wish to illustrate, which is how benefits under UI and payments under the family assistance plan vary relative to each other with previous earnings.

These are shown separately and then superimposed in the diagrams (diagrams A, B, C). Reading vertically, on diagram C, wherever the family assistance payment is higher than UI, although UI would have to be paid, the total received would be determined by the family assistance payment level. This is clearly the case for low-earnings families and more so for larger than for smaller families. Four-person

³¹ The tax rates in effect under a demogrant would depend on the liberality of the demogrant or tax credit, the extent of comprehensiveness in the base of taxable income, and whether the tax is to be proportional or progressive. See Benjamin A. Okner, "The Role of Demogrants as an Income Maintenance Alternative," in *Concepts in Welfare Program Design, Studies in Public Welfare*, Paper No. 9, Subcommittee on Fiscal Policy of the Joint Economic Committee (Washington, D.C.: Government Printing Office, forthcoming).

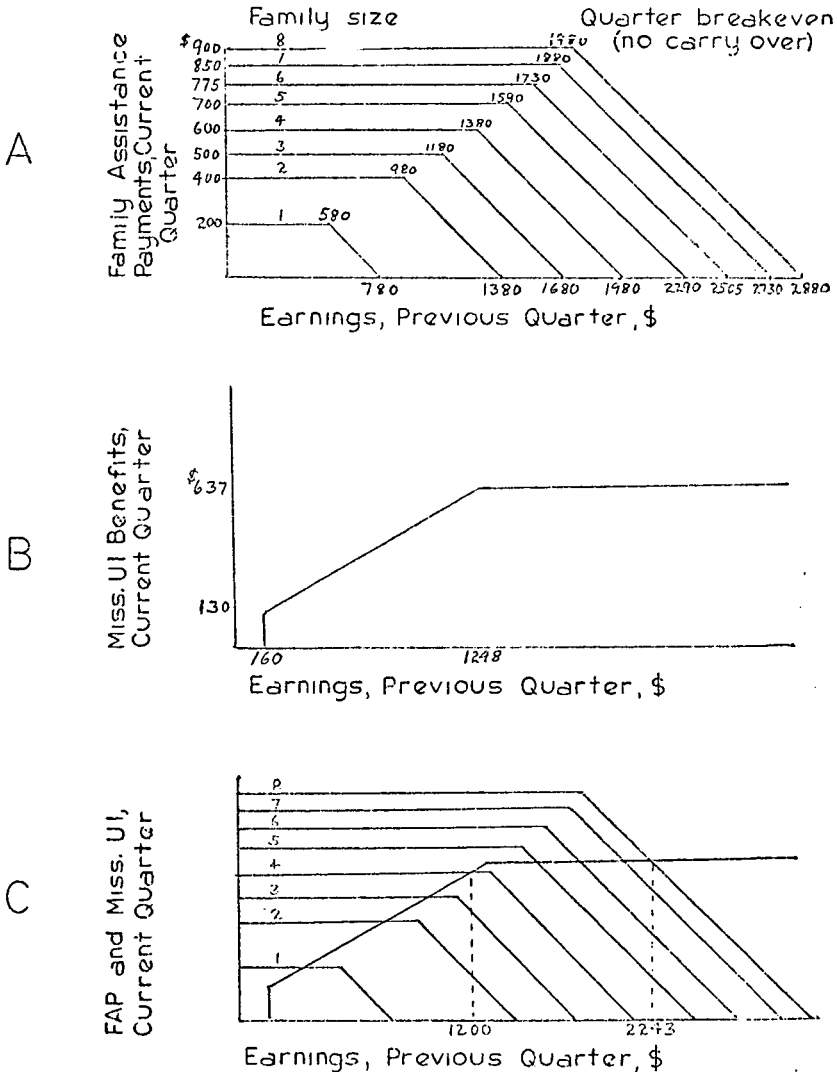
³² Actually, Mississippi uses a base year that is the first four of the five quarters preceding the benefit year. Only four States use the preceding quarters. The base period refers to the preceding period of time which is examined to determine whether UI applicants meet the conditions of eligibility (e.g., sufficient length of employment above specified minimum levels of pay).

families whose head earned less than \$1,200 a quarter or eight-person families whose head earned under \$2,243 a quarter would in effect have had their UI eclipsed by the family assistance plan in Mississippi.

According to earnings data from Mississippi³³ more than half and maybe as many as 70 percent of families have earnings that fall under these levels.

Diagrams A B C

UI Benefits and Family Assistance Payments as Functions of Previous Earnings



³³ U.S. Department of Health, Education, and Welfare, Department of Social Security Administration, Office of Research and Statistics, *Earnings Distributions in the United States, 1967* (Publication No. 72-11900).

The extent of eclipse will vary positively with the liberality of an income-tested plan, negatively with the State's earnings level, and negatively with the liberality of the UI benefit structure. But after some experimenting with other States, I have concluded that the latter is relatively unimportant; that is, the variation in UI plans as now constituted is not a significant factor.

However, the other two factors are quite important, and lead to this conclusion: The variation in income levels around the United States is so significant, that to achieve a satisfactory integration of UI and income-tested plans, it seems compelling that such plans provide for regional variation in their guarantee levels. The apparent alternative—reducing the payments of an income-tested plan by less than the full amount of UI benefits—is seriously constrained by work disincentive effects. (This will be shown in a later section on "Treatment of UI Benefits.")

THE SEARCH FOR DEMOGRANTS EQUIVALENT TO UI

As we have just seen, it is deceptively easy to substitute an income-tested plan for UI, even without overtly intending to do so. With a demogrant, an intent to substitute requires positive action repealing UI. Otherwise, UI will be paid in addition to the demogrant. Is it possible to devise a demogrant that will be an acceptable substitute? If the demogrant is large enough, will it be regarded as the equivalent of UI benefits now received?

First, let us take "equivalency" in a political sense of "the greatest good for the greatest number," which overrules individual interests for those of the group. Any particular demogrant can be made progressively more generous until the majority will accept it as a substitute. We assume each person weighs the loss of UI protection and the gain of a demogrant (though we do not forget that some lose through the demogrant). Assuming the technical problems of knowing individual preferences can be solved,³⁴ there are two remaining conceptual problems. Is everyone in the society voting or just those covered by UI? A majority with a direct interest in the UI program may be a majority of the voting population. If society enacted UI as a kind of social contract with wage and salary workers to com-

³⁴ In the case of each individual now covered by UI, we can presume that it has some value to him, depending on how much he is exposed to the risk of unemployment and how strong his preference is for security over uncertainty. Many people would be willing to buy unemployment insurance if it were optional and offered in the open market, and the price each would pay would depend on the strength of his preference. It is to the point here that if we had such a hypothetical demand schedule for UI, it would also serve as a kind of demand schedule for a demogrant substitute for UI. The price each individual would pay for UI is also the amount of certain payment he would accept in exchange for giving up UI protection. His preference for a demogrant substitute to UI is mirrored by the cost of giving up UI protection; this is the meaning of equivalency. In the aggregate schedule there will be some point at which over half the population will prefer a particular demogrant to UI. All those with a higher equivalency price will simply be outvoted. Unfortunately, this does not get us very far because we do not know the demand schedule for UI. We could estimate the distribution of beneficiaries by their risk exposure, but in the absence of a market for UI benefits we know nothing of people's risk tolerance or preference for security although it might be possible to develop proxies using purchase of life or accident insurance.

pensate them for their role in an economy dominated by private capital, can this society turn around and outvote a majority of these workers? But the more important difficulty is that in most States the size of family does not affect the UI payment whereas family size could be an important variable for demogrants. Equivalency is a function of both UI preference and family size, and in the majority voting for the demigrant there will be larger families than in the minority still preferring UI. Since it makes a difference, does majority mean majority of persons or majority of families?

At the other extreme there is a different concept of equivalency; namely, that no one should be worse off under the demigrant than he was before under UI. Here the concern is with the largest group of recipients of unemployment insurance who have the most at stake. Although a final determination of equivalency, if one could be made, would be toward some compromise between "no one worse off" and the "greatest good for the greatest number," the social contract view of unemployment insurance suggests caution in moving too rapidly from the former to the latter.

What amount of benefits is it possible to receive under the most liberal State programs? Two kinds of variation must be considered: Whether to include dependents' allowances since only 11 States have these; and whether to consider benefits under the Federal-State triggered extensions which raise State benefits to a potential 39 weeks. A strict reading of our criteria will mean taking the high side in all cases, but in table 1 the States are shown both with and without the triggered extensions, and with and without dependents' benefits. The largest benefit payable in the course of a year is over \$5,000 to a single person, but the number of States in the range over \$4,000 or even over \$3,600 is sparse.

Now, with what aspect of a demigrant should this be compared? It is not difficult to design several kinds of demogrants that provide a family of four with tax credits of \$4,000, but we must be concerned with change after both credit and tax, that is, with net change in disposable income occurring as a result of enactment of the demigrant, in order to have a comparison with UI.

Okner has calculated these gains and losses for various sized families of different pretax and transfer income levels.³⁵ These are shown in table 2, for two different demigrant schedules. The UI levels (table 1) and the demigrant changes (table 2) are compared graphically in diagram D.

³⁵ Benjamin A. Okner, "The Role of Demogrants as an Income Maintenance Alternative" (unrevised, unpublished).

TABLE 1.—*Distribution of States by maximum annual potential unemployment insurance benefits, August 1972*

Maximum, possible annual UI benefits	With Federal-State extensions ¹		Without Federal-State extensions	
	Including dependents' allowance	Excluding dependents' allowance	Including dependents' allowance	Excluding dependents' allowance
\$5,400 to \$5,000-----	2 (Connecticut, District of Columbia).	1 (District of Columbia).	-----	-----
\$5,000 to \$4,600-----	-----	-----	-----	-----
\$4,600 to \$4,200-----	1 (Massachusetts).	-----	-----	-----
\$4,200 to \$3,800-----	1 (Rhode Island).	-----	-----	-----
\$3,800 to \$3,400-----	5-----	2-----	1-----	1-----
\$3,400 to \$3,000-----	8-----	9-----	2-----	-----
\$3,000 to \$2,600-----	11-----	12-----	3-----	2-----
\$2,600 to \$2,200-----	18-----	19-----	8-----	6-----
\$2,200 to \$1,800-----	4-----	6-----	11-----	12-----
\$1,800 to \$1,400-----	1-----	2-----	24-----	26-----
\$1,400 to \$1,000-----	-----	-----	2-----	4-----
Total number States. ²	51-----	51-----	51-----	51-----

¹ Under Employment Security Amendment of 1970.² Includes District of Columbia.TABLE 2.—*Average change in disposable income as result of 2 types of demogrants, by family size and income class*

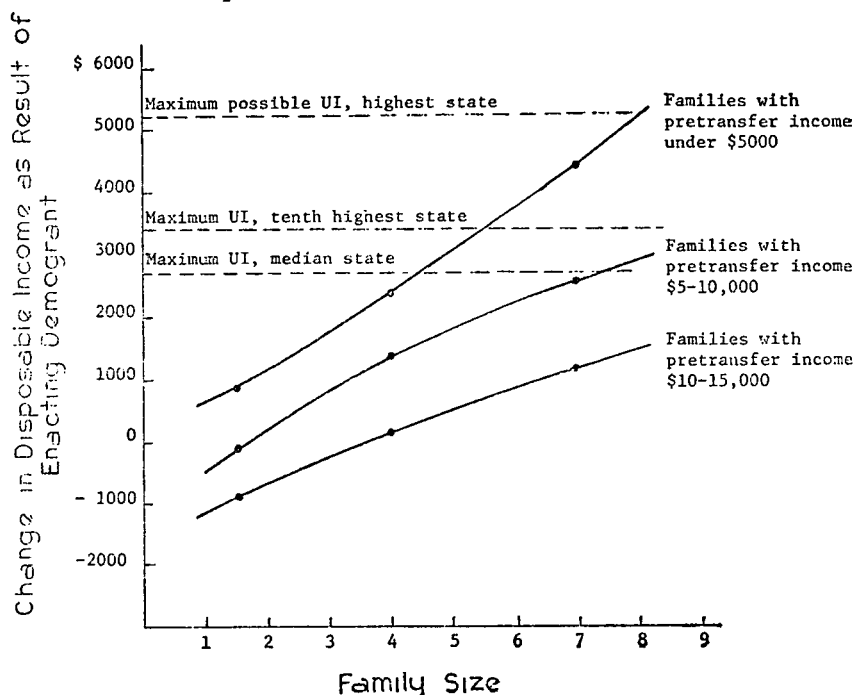
Family size	Benefit schedule	Change in disposable income by family income class		
		Under \$5,000	\$5,000-\$10,000	\$10,000-\$15,000
Demigrant I:				
1-----	\$1, 000	+ \$559	- \$533	- \$1, 432
2-----	2, 000			
3-----	3, 000			
4-----	4, 000	+ 2, 225	+ 1, 378	+ 137
5-----	5, 000			
6-----	6, 000			
7-----	7, 000	+ 6, 012	+ 4, 091	+ 2, 665
8-----	8, 000			
9+-----				
Demigrant II:				
1-----	\$1, 250	+ \$908	- \$130	- \$973
2-----	2, 500			
3-----	3, 250			
4-----	4, 000	+ 2, 310	+ 1, 330	+ 82
5-----	4, 500			
6-----	5, 000			
7-----	5, 250	+ 4, 300	+ 2, 436	+ 1, 104
8-----	5, 500			
9+-----				

Source: Computed from Okner, "The Role of Demogrants as an Income Maintenance Alternative" (unrevised, unpublished version).

The comparison suggests that high risk families who are likely to draw heavily on UI will prefer UI under the following conditions: Where the family is small; where the family is middle-sized with middle or high income; where the family is middle-sized with low income and is living in one of the States with more liberal UI than the average. Demogrants will be favored even by heavy UI users where the family is both large and low income; and where the family is large with a middle income but living in a State with low UI benefits.

Diagram D

Maximum Potential UI Benefits Compared With Average Change in Disposable Income Under Demigrant II



Integration With Income-Tested Plans

THE PROBLEMS OF INTEGRATION

A basic question about any income maintenance plan is the effect it will have on work incentives. When new plans are added, the subject of incentives is even more sensitive because of cases of entitlement to payments from more than one program.

The appropriate analysis is in terms of three separate but related concepts. The first is the basic benefit level or "guarantee" (sometimes referred to as potential payment), which refers to the amount the beneficiary or family receives from the plan if they have no other income. In unemployment insurance the "guarantee" is the benefit paid for full unemployment; in income-tested plans it is the payment when there are no other forms of income, earned or unearned. In demogrants, the guarantee is simply the value of the tax credit for the family.

The amount of the guarantee, or sum of guarantees if more than one entitlement is involved, may adversely affect work attitudes particularly if it approaches the level of previous earnings which condition a family's standard of living or if it approaches standards of living prevailing in the area around the beneficiary.

The second concept for analyzing disincentives is the effect on disposable income (after-tax income) of any rise in earnings. Since most income maintenance plans have explicit provisions about alteration of the payment with increments of income, the disposable income is affected in two ways: From the increment in earnings and from any reduction in payments. If the payment is reduced by 50 cents for each dollar of earnings, disposable income has increased not by the dollar of earnings, but by half of it. This is sometimes referred to as an "implicit marginal tax on earnings."

In unemployment insurance, the effect on benefits of any earnings during the benefit week is determined by the partial benefit schedule. It is not uncommon to find benefits reduced by the amount of earnings, in effect a 100 percent implicit marginal tax rate. In income-tested plans, the payments are usually reduced dollar for dollar by the amount of unearned income, but by only a fraction of earnings, in order to avoid a complete disincentive to work. In demogrants, the scheduled tax credit or guarantee is nominally unaffected by earnings, and remains the same for all individuals or members of the family.

But this is not the end of the matter, because in any income-tested plan or demogrant which is an integral part of the Federal income tax system (or which gets its funds from general revenues), the cost of the plan will have an effect on the explicit taxes paid. This is the third factor bearing on incentives. Disposable income is what remains after taxes are paid and since it takes higher taxes (at least for some) to finance an income maintenance plan, the tax increment (as well as the earnings and the guarantee) will affect disposable income.

TREATMENT OF UI BENEFITS

It is a tenet of social insurance theory that benefits are earned, since the premium or contribution has been paid by the worker or his employer. According to this view, benefits are a form of deferred wages.

In the original family assistance proposal, UI benefits were treated as deferred wages. The same implicit tax rate was applied to UI benefits as applied to earnings. The Ways and Means Committee changed this to reduce program costs by counting UI as unearned income, reducing the guarantee or potential assistance payments by the full value of any UI benefits. We have already noted one of the consequences of treating UI benefits as unearned income, the possibility of causing an eclipse of UI. There are other consequences as well.³⁶

³⁶ Another consequence is that applicants for the income-tested plan may have no interest in obtaining their UI (where it is lower than the plan's guarantee). The Ways and Means Committee "solved" this simply by making application for UI of persons entitled to UI benefits a condition of eligibility for the family assistance plan. It seems to me that requiring entitled persons to claim their UI as a condition for eligibility to an income-tested plan is using the worker as the agent for an intersystem transfer. From one point of view, there is a penalty for failing to perform what is a useless act. The obligation and responsibility for collecting the UI benefit should more properly rest with the family assistance plan. This is particularly true because of the adversary character of UI administration in which employers review and contest claims.

But the question here is whether there are conflicting objectives in trying both to reduce the eclipse effect and also to minimize disincentives.

In this analysis no light can come from a metaphysical discussion about whether UI benefits really are deferred wages. Instead, let us suppose UI had been given some disregard—10, 20, 33⅓, or 50 percent. The latter two disregards compare with the treatment considered for earnings under the family assistance plan. The first two can be regarded as compromises between the “deferred wages” and the “unearned income” treatment. Under these various possibilities, is there any evidence that the total income of beneficiaries would rise to a point that work incentives would be threatened?

The analysis can be made only in terms of a specific structure, and we shall use the family assistance plan. Assume families of various size with a single earner making \$100 a week. He has worked steadily for over three quarters and then is laid off. How will his combined income from UI and the family assistance plan in the current quarter compare with his net (after taxes) income in the previous quarter, assuming various disregards of his UI benefits?³⁷

The incentive problem here is defined in terms of disposable income when unemployed, divided by previous earnings when employed. For persons drawing UI and family assistance payments, will the combination fall enough short of his previous net earnings that he would take back the old job—or one like it—if he had the opportunity? The independent variable of interest is the amount of disregard of UI benefits possible under the family assistance or other income-tested plan.

The results are shown (table 3) for two different States, Alabama and Connecticut, which have different styles in benefit formula (Connecticut varying with family size) and maximums at extremes that encompass all but five States.

The findings confirm the fact that to count UI as earnings (a 67 percent tax rate or 33 percent disregard) would have raised incentive problems, going into the range where current income was 80 percent or better of past net earnings, even in Alabama (for larger families).

However, this does not mean it is necessary to go to the other extreme and have no disregard at all. In fact, at a 20 percent disregard, not even large families in Connecticut would reach 80 percent of previous after-tax earnings. With a 20 percent disregard there would be some work incentive, and certainly incentive to collect UI.

³⁷ The method of calculating income in the current (fourth) quarter and relating it to income in the previous quarters is as follows:

$$\frac{Y_4}{Y_3} = \frac{FAB_4 + UI_4}{FAB_3 + E_3} = \frac{FAR - [UI(1-R) + C_{1+2+3}] + UI_4}{FAB_3 + E_3},$$

$$\text{and } FAR - UI(1-R) - C_{1+2+3} \geq 0$$

where Y =income, FAB =family assistance benefit, E =earnings, FAR =family assistance guarantee for each family size, R =percentage of UI disregarded, C =carryover, UI =jobless benefit, and the subscripts designate the quarter. By subtracting personal income tax withheld and social security tax in the third quarter, Y_3 becomes the net earnings. See *Report of the Committee on Ways and Means on H.R. 1, 92d Cong., 1st sess., May 20, 1971*, for a description of the benefit provisions in *FAP*.

TABLE 3.—*Unemployed quarter income as percentage of previous employed quarter net earnings, according to alternative treatments of UI income under family assistance plan, selected States*¹

Percent of UI benefits disregarded by FAP	Family size						
	1	2	3	4	5	6	7
10:							
Alabama.....	59	57	56	54	67	69	70
Connecticut.....	65	68	72	76	78	73	72
20:							
Alabama.....	59	57	56	58	72	73	74
Connecticut.....	65	68	72	77	78	78	79
33:							
Alabama.....	59	57	56	65	79	80	81
Connecticut.....	65	68	72	76	88	88	88
50:							
Alabama.....	59	57	56	74	88	88	88
Connecticut.....	65	68	72	65	101	101	100

¹ Assumes single earner families; earnings \$100 weekly in employed quarters; and that only income is earnings, family assistance payments and UI.

Cases can arise where an individual is receiving more than one social insurance benefit. A limiting principle could be applied as follows: "In computing the payment, 20 percent of benefits from unemployment insurance plans shall be disregarded; but the total received from social insurance and the payment under this plan shall not exceed 80 percent of the beneficiary's earnings in the previous period (quarter) or one-half of the State's average weekly wage whichever is greater."³⁸

If an income-tested plan does not fully offset the amount of the UI benefit, as here recommended, then there will be an increase in the implicit marginal tax rate on earnings in the integrated system. This occurs because earnings force adjustments in the payments both directly and also indirectly through the UI benefits.³⁹

Some effect is inherent and cannot be escaped, but can be diminished by lowering the rate reductions used in the UI partial benefit schedule. Connecticut, for example, uses 66½ percent rather than 100 percent

³⁸ We take our cue here from the "accommodation" made when the workmen's compensation constituency began complaining about OASDI supplementation of WC permanent and total benefits. An amendment was added to OASDI that if a disability claimant is also entitled to WC, his OASDI benefit is reduced in those months in which the total combined OASDI and WC otherwise payable to him and his dependents would exceed 80 percent of his earnings prior to his disability (subject to adjustment for changes in national earnings levels). If the combined benefits exceed this percentage, the OASDI benefits are reduced by the excess. Applying the idea to an income-tested plan may require some additional adjustments. For example, most workers can have their potential wage level defined in terms of past earnings, but for those with little previous work experience an arbitrary definition may be needed, such as some fraction of the average weekly wage of the State.

³⁹ An example will show how this works. Assume FAP with 66½ percent implicit marginal rate on earnings and a UI plan with 100 percent implicit rate. If FAP allows 20 percent of UI benefits to be retained, the chain of adjustments for \$1 of additional earnings is as follows:

\$1 increase in earnings.....	+\$1. 00
Reduction in UI of \$1.....	—1. 00
Rise in FAP of 80 cents.....	+ . 80
Reduction in FAP of 66½ cents.....	— . 66½
Increase in income, or, 86½ percent tax.....	. 13½

In effect the 20 percent disregard of UI has altered the overall implicit tax on earnings from 66½ to 86½ percent.

as in many States. An income-tested plan that treated UI benefits with a 20 percent disregard would have its implicit marginal tax rate raised by 13 percentage points in Connecticut (that is, from 50 to 63 or 67 to 80 percent) as opposed to 20 percentage points in other States.

INTERACTING MARGINAL TAX RATES

Whatever decision is made as to how an income-tested plan shall treat UI benefits, there remains an interesting problem of interacting marginal tax rates between a given State UI program and the income-tested plan. This arises because various States use different partial benefit schedules, and because any income-tested plan enacted will probably treat earnings differently than do any of the State UI plans.

If the guarantee level of an individual's UI benefits (for total unemployment) is either well below or well above the guarantee level of the income-tested plan, there is less possibility of their implicit marginal tax rates on earnings interacting. Where the UI benefit is clearly superior, then no payments will be forthcoming from the income-tested plan; for any earnings, the controlling schedule will be the UI partial benefit schedule. Where the guarantee from the income-tested plan is clearly superior to any payable UI benefits then the controlling implicit marginal tax rate on earnings will be that of the income-tested plan, even when UI benefits are also paid. The problem to which I allude arises only when the two guarantees are close enough together that increments in earnings can cause the superior plan to become inferior.

This can occur frequently because most of the State UI partial benefit schedules are still heavily dependent on 100 percent implicit tax rates, among them Alabama, Colorado, Florida, Louisiana, Mississippi, Nevada, and Texas, all of which have a small earnings disregard followed by benefit reduction dollar for dollar of earnings.⁴⁰ A claimant could start out on UI with benefits higher than his alternative family assistance payment (at a quarterly rate of \$800 compared with \$600, for example), only to find that as his earnings went up he would be entitled to family assistance payments⁴¹ (see diagram E).

⁴⁰ These schedules are found in U.S. Department of Labor, Manpower Administration, Unemployment Insurance Service, *Comparison of State Unemployment Insurance Laws* (Washington, D.C.: Government Printing Office, August 1972).

⁴¹ An example will illustrate this. The head of a hard luck family is laid off and entitled to \$62 a week in UI, or \$800 a quarter. If he had no UI coming, he would be eligible for \$600 quarterly from FAP for his family of four (with no other income, no "carryover"). The UI is clearly better and he draws. But he finds he has part-time earnings opportunities. In his State, the first \$5 of weekly earnings is ignored, after that his benefit is reduced by the amount of earnings. FAP ignores the first \$180 of earnings in a quarter and then reduces payments by 67 cents for each dollar of earnings. When our hard-pressed man starts earning more than \$34 a week, he begins to be better off under FAP, and entitled to FAP payments. The schedule below helps show how this works. It is depicted schematically in the first drawing of diagram E.

Earnings		UI benefit (quarter)	UI plus earnings (quarter)	FAP payment (quarter)	FAP plus earnings (quarter)
Weekly	Quarter				
0	0	\$800	\$800	\$600	\$600
\$5	\$65	800	865	600	665
10	130	735	865	600	730
20	260	605	865	547	807
30	390	475	865	460	850
40	520	345	865	373	893
50	650	215	865	287	937
60	780	85	865	200	980

A different situation exists in a number of States (North Dakota, Alaska, Idaho, North Carolina and others) where at zero earnings in the current quarter the individual may start off somewhat better on family assistance than on UI. But as his earnings in the current quarter rise, the situation will change and the UI benefits exceed family assistance. In some States, as his earnings continue to rise the relative advantage of UI disappears and he would again be better off on family assistance. In the extreme situation (Wisconsin, Michigan, and Nebraska), occasions can arise where in order to maximize his position, the individual would be changing back and forth between programs five times (diagram E).

Administration of an income-tested plan would have to be extraordinarily competent and sophisticated to follow the marginal rate interactions and respond in the interest of the recipient. It would undoubtedly help if the States all adopted one form of partial benefit schedule, perhaps the one that is used in Connecticut, or a schedule similar in its characteristics to that used by the income-tested plan.⁴²

Integration with Demogrants

EFFECT ON UI OF HIGHER INCOME TAX WITHHOLDING RATES

At the outset it would appear that integration of UI with a demogrant would be a much simpler and more straightforward process than integration with an income-tested plan. There are no problems of interacting implicit program tax rates although, as will be shown below, there are potential problems with Federal income tax rates. There are relationships that are troublesome, not just because they are obscure, but because they bear directly on disincentives and the purpose of UI.

Under a demogrant, taxes and withholding rates are necessarily higher, which has important implications for the ratio of UI benefits to take-home pay.

The ratio of all taxes now raised by the Federal income tax to a comprehensive tax base is about 20 percent; Okner estimates that under various demogrant proposals it could rise to 30 or 40 percent.⁴³ It is clear that at almost all levels of income, tax rates would have to be higher under a demogrant. The taxes could be proportional or progressive; when combined with a demogrant, proportional rates give progressive results. However, even if a progressive structure were retained in the rates themselves, higher rates at nearly all levels would still be needed to stay within the limits of a reasonable structure.⁴⁴

If tax rates on earnings are higher under a demogrant, then the worker confronts a different situation. His take-home pay is smaller than before the demogrant, and when laid off his wage loss is less. A smaller UI benefit will provide him the same wage-loss replacement rate as formerly, in terms of disposable income. If the withholding rate were substantial, as much as 30 or 40 percent, it becomes impossible to defend the present ratio of weekly benefits to gross wages.

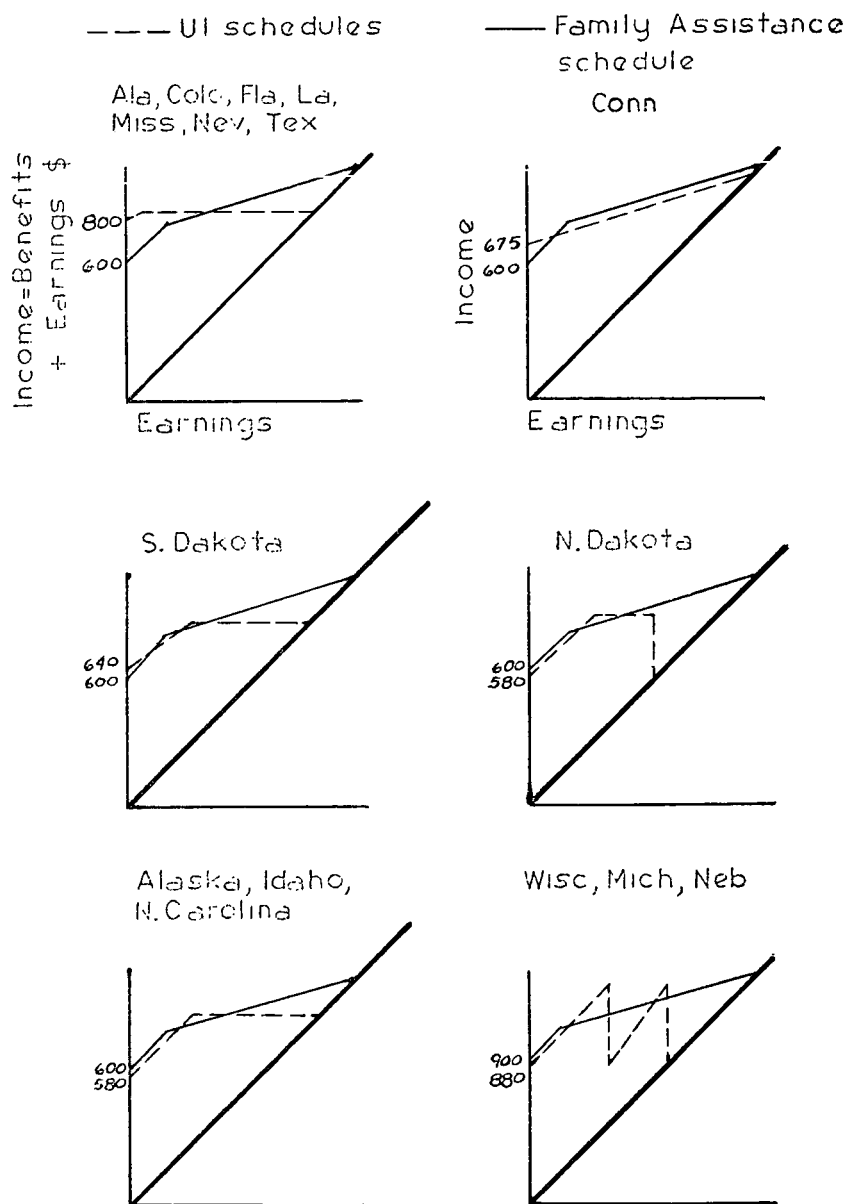
⁴² Because UI benefits are scaled at one-half weekly earnings, the breakeven point (where benefits decline to zero), has to be less than twice the guarantee and preferably, because of withheld taxes, closer to one and one-half times the guarantee.

⁴³ Okner, op. cit. (unrevised version).

⁴⁴ This does not alter in any way the fact that lower- and middle-income persons would usually be much better off under the demogrant.

Diagram E

Possible Interactions Between UI Partial Benefit Schedules and the Marginal Tax Rate in the Family Assistance Plan



One of the following adjustments would be needed: (1) Weekly benefit amounts would have to be calculated at smaller fractions of high quarter earnings; (2) weekly benefits would have to be computed in terms of take-home pay rather than gross pay; or (3) benefits would have to be made taxable and subject to withholding as are wages and salaries. This last is undoubtedly the simplest adjustment.⁴⁵

SIGNIFICANCE OF THE PAYMENT PERIOD

One possible structure for a demogrant is simply to continue to handle accounts and payments as is done now: In April, the taxpayer calculates his tax and withholding and either makes a payment or receives one depending on the balance. Under a demogrant, the withholding rate could be estimated with both the tax credit and the expected earnings in mind and the April accounting would be an adjustment of unanticipated differences. This approach would leave the working parts of UI largely untouched.

A different model, which I shall call the "support model," would provide for regular payment of benefits to the family on a weekly, biweekly, or monthly basis. The advantage of this model is that low-income persons would have some form of regular support during the year instead of receiving one big lump sum payment in the spring.

The support model would help UI in two very difficult policy areas, benefit duration and wage qualifying requirements.

How long should UI be expected to provide benefits? There is general acceptance of State program responsibility up to 26 weeks, but beyond that is a no man's land in which some States have ventured while others fear to go, with the result that Congress sometimes has acted hastily with regard to triggered extended benefit programs. A demogrant of the support model could serve the useful role of relieving UI of concern with persons unemployed beyond 6 months. For persons of long-term unemployment, there is a strong case for a demogrant rather than UI as the base of support. As time since the last job increases, previous earnings become less relevant; and there develops more justification for applying minimum social needs criteria. Furthermore, long-term benefits are more appropriately financed from general revenues than from a payroll tax.

The problem with wage-qualifying requirements is that if the minimum benefit is raised, the wage-qualifying requirement gets more restrictive, and there is therefore no logical way by which UI can improve the situation for low-income, irregularly employed persons. A demogrant would provide support for such persons and also give more flexibility to UI in defining eligibility. States now generally insist on 14 to 20 weeks of work as minimum evidence of past attachment to the labor market.⁴⁶ If State laws were to require 20 weeks of work—

⁴⁵ To compute in terms of take-home pay would introduce inequities because of differences between taxes withheld and actual taxes after end-of-year adjustment. Moreover, States that use quarterly or annual earnings would have no way of applying the take-home pay concept.

⁴⁶ Minimum required earnings for the high quarter range from \$75 to \$416 and for the base year from \$200 to \$1,200, depending on the State. These are stated in different ways, sometimes as minimum weeks of work, or base year earnings as multiple of high quarter earnings, or as multiples of the weekly benefit amount.

and there is some informed opinion that this is desirable—many persons now entitled to UI would not be eligible. However, if a demogrant were in effect these persons could be declared ineligible for UI and yet not be without income.

The support model of the demogrant could be built in two different ways: Either it could pay every family a regular amount that would add up over a year to the scheduled tax credit to which they would be entitled; or it could pay only to those who by virtue of their expected earnings have a reasonable likelihood of being net gainers and in the amount of their expected net gain.

Structured in the latter manner (that is, on a net basis), the support demogrant would have a useful complementary effect to UI as now constituted. We have noted in part I that UI plans in most States are not sensitive to family size, and further that the ratio of replacement of wage loss is held close to 50 percent rather than varying with income. We believe these features are unnecessarily rigid. The effect of a support demogrant would be to introduce the desired flexibility.

This can be illustrated by looking at the ratio of disposable income after layoff to disposable income while working (table 4).

TABLE 4.—*Effect of demogrant on ratio of weekly disposable income after layoff to weekly disposable income before layoff, by family size and income (using credit schedule for demogrant II)*¹

[UI= Weekly UI benefit; D= Weekly demogrant payment; E= Weekly earnings prior to layoff]

		After demogrant		
		Amount of demogrant		
	Now—UI÷E= Ratio ²	Annual	Weekly	(UI+D)÷(E+D)=Ratio
Typical situations:				
Small family:				
Low wage-----	38÷ 76=0. 50	\$908	\$17	(38+ 17)÷(76+ 17)=0. 60
Middle wage ³ -----	72÷144= .50			
Higher wage ³ -----	80÷240= .33			
Middle-sized family:				
Low wage-----	38÷ 76= .50	2, 310	44	(38+ 44)÷(76+ 44)= .68
Middle wage-----	72÷144= .50	1, 330	26	(72+ 26)÷(144+ 26)= .58
Higher wage-----	80÷240= .33	82	2	(80+ 2)÷(240+ 2)= .34
Large families:				
Low wage-----	38÷ 76= .50	4, 300	83	(38+ 83)÷(76+ 83)= .76
Middle wage-----	72÷144= .50	2, 436	47	(72+ 47)÷(144+ 47)= .62
Higher wage-----	80÷240= .33	1, 104	21	(80+ 21)÷(240+ 21)= .39
Extreme situation:				
Low-income families of 8, with maximum demogrant earnings:				
\$70-----	35/70= .50	5, 500	106	(35+106)÷(70+106)= .80
\$60-----	30/60= .50	5, 500	106	(30+106)÷(60+106)= .82
\$50-----	25/50= .50	5, 500	106	(25+106)÷(50+106)= .84
\$40-----	20/40= .50	5, 500	106	(20+106)÷(40+106)= .86
\$30-----	15/30= .50	5, 500	106	(15+106)÷(30+106)= .89
\$20-----	10/20= .50	5, 500	106	(10+106)÷(20+106)= .92
\$10-----	5/10= .50	5, 500	106	(5+106)÷(10+106)= .96

¹ See schedule for demogrant II on table 2.

² UI maximum assumed to be \$80.

³ These families are, on the average, net losers; this analysis does not apply to them.

From an incentive standpoint the ratios of disposable income after layoff to disposable income prior to layoff are acceptable, except in the extreme and rare cases of the largest families with the lowest incomes and the largest demogrants. Fortunately a simple solution is available, a small change in UI. An 80 percent limiting principle could be applied to the effect that any demogrant received should not affect UI benefit amounts unless together they exceed 80 percent of both earnings and demogrant in the average work of the high quarter of the base year, in which case UI would be reduced accordingly. This limiting principle will be rarely applied however, since by far the bulk of cases will be found in a zone "safe" with regard to disincentives.

We have suggested two minor changes for integrating a support demogrant with UI—treating UI benefits as taxable income, and a limiting formula. With these features, a successful integration occurs that solves the duration and minimum wage qualifying problems that have long plagued UI, and which also improves the weekly income available on layoff in just the right ways, positively with family size and negatively with the level of earnings.

PUBLIC MEDICAL PROGRAMS AND CASH ASSISTANCE: THE PROBLEMS OF PROGRAM INTEGRATION

By THEODORE R. MARMOR*

SUMMARY

Medicare and medicaid have a substantial place in our current public income transfer programs. In 1971, medicare and medicaid expenditures amounted to 54 percent of the \$25.6 billion Government expenditures for health. Medicare separately accounted for \$7.9 billion and medicaid, with 17 million beneficiaries, involved Federal, State, and local expenditures of \$6 billion. Since the enactment of these two programs in 1965, expenditures have increased dramatically. Indeed, while the debate over welfare reform concentrated on cash assistance, in practice, Government action expanded in-kind services. Because medicare and medicaid programs reflect social insurance conceptions on one hand and public welfare conceptions on the other, it is all the more important to address the problem of integrating these transfer programs of contrasting style.

1. *The problem of eligibility.*—Practically all aged persons are eligible for medicare's hospital (part A) and physician (part B) benefits. Hospital insurance (HI) is available to all persons over age 65 with some minor exceptions, and supplementary medical insurance (SMI) is open to all over age 65 upon payment of a monthly premium of \$5.80. Over 96 percent of the aged participated in medicare's twin programs during 1971.

Medicaid was originally designed to finance health services to a large proportion of America's low-income population, requiring coverage for all persons eligible to receive cash assistance and permitting States to include the medically indigent. Medical indigence was defined to mean people in public assistance categories (only) who are financially eligible for medical but not for financial assistance. This definition of medical indigence excludes all those people who are not aged, blind, disabled or with children under 21. Furthermore, in roughly half the States as of July 1971, medical assistance was restricted to those eligible for cash assistance only, thus reaching even fewer people than the law allowed. As a result, equity problems are central to the legal and administrative provisions of medicaid.

2. *Benefit scope.*—Considering medicare and medicaid together underscores the interdependence arising from the benefit stringency of the former and the residual role of the latter. The original medicare statute very carefully specified benefits in terms of number of days of hospitalization, deductibles, and copayments, whereas medicaid,

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varying with State regulations, covers most medical care. They overlap at several points. Medicaid officials are encouraged to "buy-in" part B medicare coverage for the needy aged who are unable to pay the monthly premium. Medicare's narrow definition of nursing-home-care benefits, intended to reduce the program's costs, meant that medicaid regulations covering "skilled nursing homes" opened the way to transfer some of the needy aged onto its rolls. In States where medicaid is not extended to the medically indigent, hospitals are forced into a residual financing role whereby they either bill a low-income, aged patient or accept the bill as a bad debt when neither medicare nor medicaid will cover the cost of care.

3. *Financing issues.*—Medicare is financed by a combination of social security taxes, general revenues, and premiums, deductibles, and coinsurance paid by beneficiaries. It does not employ income tests and thus avoids the difficulties of different programs which singly or in combination reduce benefits as income increases. On the other hand, difficult issues arise in valuing the medicaid subsidy and in assessing the cumulative tax rate and notches. The notch for cash assistance recipients comes from the sudden termination of all medicaid benefits when additional earnings make them ineligible for public assistance. The notch obviously creates substantial incentives to avoid earnings which would make one ineligible for medicaid. A different problem arises for medically indigent persons whose incomes are too high for cash assistance standards, but whose medical expenses reduce their disposable income below the State maximum payments for public assistance. Such families face 100 percent tax rates on earnings above the eligibility line. Thus, a dollar of additional earnings makes them no better off.

The equity problem is apparent when one contrasts the conditions of entrance into medicaid with those of exit. Because of the difference between the entrance eligibility standard and the cutoff point, families with equal incomes receive different treatment depending on whether they first entered the medicaid program and then increased their income, or never entered the program at all.

Although the notch problem has dominated much recent reform discussion, it is the cumulative tax rate issue that is central to reform proposals which would reduce the value of the medicaid subsidy as income increases. The suggestion raises a dilemma. To leave present recipients no worse off would require reducing medicaid's subsidy only at income points above the cutoff, which would cover millions of people and be very costly. On the other hand, if the subsidy were reduced to zero at the present cutoff point many current medicaid beneficiaries would be worse off, either by receiving only a partial subsidy or by losing entirely what now amounts to a valuable, free health insurance policy to the recipient.

4. *Method of financing.*—The present methods of financing medicare and medicaid encompasses the range of usual possibilities: social security payroll taxes, general Federal revenues, beneficiary contributions (premiums, deductibles, and coinsurance), and general State and local funds. The general revenue funding of medicaid is almost certainly more progressive in its distributional impact than are the tax sources for medicare.

Those tax sources differ for the two parts of the medicare program. Part A is financed by an earmarked part of the general social security payroll tax, giving beneficiaries the sense that they have "paid for"

their benefits and also creating the politically important sense that such funds are protected. Part B is financed by premiums paid half by beneficiaries and half by general Federal revenues. There is also a mixture of cost-sharing features in both components of medicare. In 1970, nearly \$7.9 billion was spent by the Federal Government for medicare expenses.

Unlike medicare, medicaid, financed from general revenue sources and subject to yearly congressional review, has been criticized intensely and its original benefit and eligibility scope have been cut. Whether this is because of the program's method of financing or its clientele is difficult to tell. Some support for the latter view can be found in the fact that medicare's part B has been cut back with part A in spite of their different methods of financing. All of these remarks stress the burdens entailed by the methods of financing Government health programs. They do not try to deal simultaneously with the distribution of benefits. There is considerable merit in separating the issue of what insurance one wants to provide from how the Government should finance that package. And, in that financing choice, one must be explicit about the ideological and political benefits connected with social insurance programs and not be mystified about the causes of those benefits.

5. *Cost-sharing and the problems of integration.*—The rapid growth of medicaid has made cost control a dominant theme of the medicaid debate as well as that on health insurance generally. However, cost-sharing obviously conflicts with the goal of removing the financial obstacles to medical care. Cost-sharing devices, such as premiums, deductibles, and coinsurance/copayment, would reduce the financial incentives for entering medicaid and present problems for the cumulative tax rates which current recipients face. The problem of using cost-sharing while not reducing benefits for current recipients is not solved in any current reforms suggested for medicaid. All proposals result either in a high income eligibility cutoff point, thereby making a large percentage of the population eligible for some medicaid subsidy, or a lower cutoff which would make current medicaid recipients worse off.

6. *Program interactions.*—The interaction between medicaid and medicare is fiscally encouraged as a matter of Federal policy. By July 1970, there were nearly two million public assistance recipients enrolled for medicare's supplementary medical insurance under welfare "buy-in" agreements—that is medicaid paid the medicare premiums for part B coverage. From January 1970, Federal matching was no longer to be available for any expenditures for medicaid services that would have been financed by medicare if the patient had been enrolled in the SMI program. How much fraudulent billing has occurred because of this overlap is difficult to estimate precisely.

After raising a number of program integration issues in connection with the current operation of medicare and medicaid, the remainder of the paper focuses on issues of equity and combined tax rates that arise when welfare reform and medical care reform are considered simultaneously. Comment is restricted to a pair of welfare reform proposals and a pair of medical care reform plans

The two welfare reform plans are the Nixon administration's proposal as embodied in the House-passed version of H.R. 1 and a demogrant plan. These are two income redistribution plans of a nega-

tive tax type: one guaranteeing \$2,400 per year for a family of four; the other, \$3,600 per year for a family of four. The former restricted to families with children; the latter universal. The former reducing benefits as earnings rise at a 67 percent rate; the latter at a 33 percent rate. Financing of the more generous demogrant would require extensive tax reform as an integral part of the plan.

The two medical plans are both variants of national health insurance. The first is the Kennedy-Griffiths proposal (H.R. 22, S. 3) and the second is the catastrophic risk plan proposed by Prof. Martin Feldstein and known as major risk insurance (MRI). While both plans are universal and comprehensive in coverage, the former has no income-testing or cost-sharing devices whereas MRI proposes a large income-related deductible—10 percent of annual family income.

The problems of the MRI and the H.R. 22 health care plans are—for our purposes—those of equity, cumulative tax rates and adequacy. The difficult questions of resource allocation, tax burdens, and efficiency which they also raise fall outside this paper's scope. MRI removes the financial barrier against very expensive care, and, according to critics, subsidizes costly care at the price of discouraging preventive care. In fact, both plans require a social choice about the distribution of expensive treatment; regulation would have to substitute for the constraints which financial means (including insurance) now provide in deciding who lives when the price of maintaining life is very high. Rationing costly medical procedures under MRI would be public and visible, and, one hopes, fair. The H.R. 22 plan raises similar rationing problems by fixing a national health budget, but rationing would be required over a larger range of services than MRI. These brief remarks are not meant to foreclose discussion but to suggest that when integration problems among public welfare programs are lessened by universal health plans, other issues arise in their place.

INTRODUCTION

This paper addresses the question of how the public financing of medical care is and should be combined with income-related cash transfers. It deals with the issues of equity, efficiency, work incentives, and benefit levels that arise when one considers the joint provision of cash and in-kind services such as medical care. The first part addresses these issues in connection with the operation of medicaid and medicare, our two largest public medical care programs. The second part addresses these same issues in connection with two income maintenance plans (a demogrant and a negative income tax.)

PART I. MEDICARE AND MEDICAID

Medicare and medicaid have a substantial place in our current public income transfer programs. In 1971, medicare and medicaid expenditures amounted to 54 percent of the \$25.6 billion Government expenditures for health. Medicare separately accounted for \$7.9 billion, and medicaid, with 17 million beneficiaries, involved Federal, State, and local expenditures of \$6 billion. Since the enactment of these two programs in 1965, expenditures have increased dramatically, as table 1 demonstrates. Indeed, while the debate over welfare reform con-

centrated on cash assistance, in practice Government action expanded in-kind services. Because medicare and medicaid programs reflect social insurance conceptions on one hand and public welfare conceptions on the other, it is all the more important to address the problem of integrating these transfer programs of contrasting style.¹

1. The Problem of Eligibility

Practically all aged persons are eligible for medicare's hospital (part A) and supplementary medical (part B) benefits. Hospitalization insurance (HI) is available without premium charge to all persons over 65, with some minor exceptions. The supplementary medical insurance (SMI) is open to all the aged upon payment of monthly premiums of \$5.80. In 1970, 96.2 percent of the 20.4 million aged were participating in the SMI program.²

TABLE 1.—*Government health expenditures for medicare and medicaid, fiscal years 1966–67 through 1970–71*

[In billions of dollars]

Fiscal year	Medicare			Medicaid
	Total	HI	SMI	
1966–67-----	3. 4	2. 6	0. 8	2. 2
1967–68-----	5. 4	3. 8	1. 5	3. 6
1968–69-----	6. 6	4. 8	1. 8	4. 4
1969–70-----	7. 1	5. 0	2. 2	5. 0
1970–71-----	7. 9	5. 6	2. 3	6. 5

Source: U.S. Department of Health, Education, and Welfare, Social Security Administration, "National Health Expenditures, 1929–70," by Barbara S. Cooper and Dorothy P. Rice, *Social Security Bulletin*, XXXIV, No. 1 (1971).

U.S. Department of Health, Education, and Welfare, Social Security Administration, "5 Years of Medicare—A Statistical Review," by Howard West, *Social Security Bulletin*, XXXIV, No. 12 (1971).

It should be recalled how this nearly universal coverage emerged. Such a pattern would not have occurred had medicare been restricted to fully insured social security beneficiaries. Instead, part A "blanketed-in" the uninsured aged, using as the eligibility condition age 65 alone rather than social insurance participation. (This was changed after 1968, reintroducing social insurance participation as a condition of eligibility but affecting only the decreasing proportion of aged persons who are not insured by social security.) In part B, for which enrollment and payment of monthly premiums are required, social insurance participation was not a condition at all. This use of an age criterion is in sharp contrast with the more complex eligibility processes of medicaid.

Medicaid was originally designed as a State-option program to finance health services to a large proportion of America's low-income population. The 1965 legislation required each participating State to cover all persons receiving or eligible to receive cash assistance

¹ By integration problems I mean the effects for persons receiving two or more benefits on the total benefit level, the eligibility for and administration of each, and incentives to work. For the latter issue the salient question is what rate of reduction of benefits applies to earnings increases, the cumulative tax rate.

² U.S. Department of Health, Education, and Welfare, Social Security Administration, Office of Research and Statistics, "Medicare: Number of Persons Insured, July 1, 1966–July 1, 1970," *Health Insurance Statistics*, May 19, 1972.

and permitted States to include the medically needy blind, disabled and dependent children (as well as the medically needy aged) at the option of the State.³ However, its implementation has produced horizontal inequities⁴ and substantial regional variation in eligibility and benefits. In roughly half the States as of July 1971, medicaid benefits were restricted to persons already eligible for one or another of the federally financed assistance categories.⁵ As table 2 makes plain, the rest of the States had expanded their medicaid programs to a "medically needy" population larger than the categorically poor. The latter group included persons and families who otherwise would have been eligible for one of the categorical programs but whose income, before medical expenses, exceeded eligibility limits.

TABLE 2.—*Federal medical assistance percentage¹ for medicaid financing and treatment of medically indigent by State*

States excluding medically indigent: ²		States including medically indigent: ³	
	Percent		Percent
Alabama.....	78	California.....	50
Arkansas.....	79	Connecticut.....	50
Colorado.....	58	District of Columbia.....	50
Delaware.....	50	Guam.....	50
Florida.....	61	Hawaii.....	51
Georgia.....	70	Illinois.....	50
Idaho.....	72	Kansas.....	59
Indiana.....	55	Kentucky.....	73
Iowa.....	58	Maryland.....	50
Louisiana.....	73	Massachusetts.....	50
Maine.....	69	Michigan.....	50
Mississippi.....	83	Minnesota.....	57
Missouri.....	60	Nebraska.....	58
Montana.....	67	New Hampshire.....	59
Nevada.....	50	New York.....	50
New Jersey.....	50	North Carolina.....	73
New Mexico.....	73	North Dakota.....	71
Ohio.....	54	Oklahoma.....	69
Oregon.....	57	Pennsylvania.....	55
South Carolina.....	78	Puerto Rico.....	50
South Dakota.....	70	Rhode Island.....	50
Tennessee.....	74	Utah.....	70
Texas.....	65	Vermont.....	65
West Virginia.....	77	Virgin Islands.....	50
Wyoming.....	63	Virginia.....	64
		Washington.....	50
		Wisconsin.....	56

¹ Federal medical assistance percentage: Rate of Federal financial participation in a State's medical vendor payment expenditures on behalf of individuals and families eligible under title XIX of the Social Security Act.

² These States offer basic required medicaid services for people receiving federally supported financial assistance.

³ These States also offer medicaid services for people in public assistance categories who are financially eligible for medical but not for financial assistance.

Source: U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, Public Information Office, 1971.

Odd effects are produced by this definition of medical indigence wherein medical care costs reduce incomes to below the State-set income level for basic maintenance needs. This "protected" income

³ U.S. Congress, Senate Finance Committee, *Medicare and Medicaid: Problems, Issues, and Alternatives*, February 1970, p. 42.

⁴ By horizontal inequity is meant the unequal treatment of persons in similar circumstances (e.g., low income).

⁵ Two States, Alaska and Arizona, have never adopted the medicaid program.

level may not exceed 133 percent of the maximum amount payable to AFDC recipient families of comparable size. It means that all poor people who are not aged, blind, disabled, or with children under 21 cannot be treated as medical indigents. It is another anomaly highlighted by the rediscovery of the working poor in connection with recent welfare reform efforts. Equally poor families which are not in the appropriate demographic categories are thus not equally eligible for even the medically indigent program under medicaid. And those eligible for the medical indigent program are not treated equally in the various States. Horizontal equity problems are thus central to both the statutory and administrative provisions of medicaid.

2. Benefit Scope

What services are covered (and excluded) and what groups bear the cost of excluded services? By considering medicare and medicaid together, the interdependence arising from the benefit stringency of the former and the residual role of the latter is made clear.

The original medicare statute did and still does include the following major benefits: 60 days of hospitalization with a deductible of roughly 1 daily service charge; 100 days of extended care facilities (following 3 days of hospitalization, with a \$20 deductible and a \$5 per day copayment after the 20th day); home health services, reimbursement of physician services (with a \$50 deductible and a 20 percent copayment); and diagnostic services such as X-rays and laboratory costs. Drugs provided outside the hospital were not covered and nursing home care other than that required for post-hospital convalescence was expressly excluded. This benefit package, never intended to be comprehensive, was in fact copied from the insurance plan available to Federal employees.

The mixture of deductibles, coinsurance, premiums, and exclusions virtually assured that medicare and medicaid would overlap. For some, the overlap would arise from the aged's inability or unwillingness to pay the monthly premiums for medical insurance (originally \$6 a month per couple, now \$11.60). State medicaid officials were first encouraged (and later pressured financially) to "buy" medicare part B coverage for recipients of old-age assistance. In 1971, some 2 million of the 19.6 million SMI enrollees were financed thus.⁶

Interdependence arose as well from the effort to reduce medicare program costs by excluding or narrowly defining benefits that aged persons could be expected to seek. The most dramatic example is nursing home services. Attempts were made to restrict medicare's financial responsibility to convalescence of formerly hospitalized patients in specially organized "extended care facilities" (ECF). The use of special jargon—distinguishing ECF's from nursing homes—indicated conscious design. Indeed, when explaining this benefit to the Congress in 1965, the Secretary of Health, Education, and Welfare (HEW) explicitly contrasted post-hospital skilled nursing and rehabilitative care from the "long-term custodial care furnished in many nursing homes" which medicare would not finance.

Predictable difficulties arose from this effort to treat a problem by defining it away. First, ECF expenditures under medicare were dramatically higher than expected, indicating that physicians, patients,

⁶ "Medicare: Number of Persons Insured," *op. cit.*

and intermediaries were not complying fully with the narrow definition of benefits. HEW estimated 0.16 ECF days per medicare beneficiary in the first full year of operation; 1967 expenditure data revealed utilization rates of approximately 1 day per enrollee, and average costs of over \$18 a day in contrast with the HEW estimate of \$11.27.⁷ The restrictive definition of benefits thus only partially constrained the demand for nursing home services.

Medicare's extended care benefits probably increased medicaid's expenditures for skilled nursing home services as well. Medicaid regulations excluded purely custodial care, but a reference to "skilled nursing homes" opened the way to a transfer of some of the worst-off aged onto its rolls. The aged who required custodial care—those who were chronically ill or senile or incapable of caring for themselves—either had to pay for nursing home services themselves, get into a hospital and induce a physician to require extended care facilities, or become eligible for medicaid's medical indigency program (where that was available) by spending enough on health care so that their income fell to the State-set eligibility level for the medically needy. Medicaid thus is the net under medicare's aged; its residual role makes overlap between the two programs a continuing issue. Where overlap does not in fact occur (for example, in the 25 States without a medical indigence program), hospitals are forced into a residual financing role. This became a more serious issue as medicare administrators increased their cost-cutting efforts in the late 1960's. In Illinois, for instance, the medicare intermediary has begun to reject hospital bills for patients who, according to medical chart data, could have been cared for in an ECF or custodial nursing home. When the patient is ineligible for medicaid, or ECF facilities are unavailable, or nursing home spaces are impossible to procure, the hospital must bill a typically low-income, aged patient or accept the rejected bill as a bad debt. In the first 6 months of 1972, one Illinois hospital had over a half million dollars in rejected claims, involving some 80 cases of long-stay patients, with prospects of recovering from perhaps 2 percent of them. The hospital is caught between the cracks. Doctors decide when patients enter and leave the hospital, but are not responsible for the financial consequences of their actions. Medicare excludes services after they have been provided, medicaid intervenes in some cases, and the hospital or the patient is left to finance what they otherwise assumed medicare would cover.

3. Financing Issues

Medicare is largely a self-financing program and presents fewer benefit reduction or "tax rate" issues than medicaid. Medicare's hospital plan is financed by an earmarked portion of regular social security taxes; those who have been "blanketed-in" are financed from general revenue transfer to the social security trust funds. The physician program is financed quite differently, but does not present special problems of integration since it is not income tested. Enrollees pay premiums financing half the costs of the program: general revenues pay the other half, thus involving transfers from nonaged taxpayers to aged part B beneficiaries. As noted previously the size of these

⁷ *Medicare and Medicaid*, op. cit., p. 34 ff.

expenditures are very substantial. In 1970, part A Federal expenditures were \$4.5 billion; part B, \$1.8 billion.⁸

Difficult issues arise in assessing the value of the medicaid subsidy and dealing with both the cumulative tax rate and notch issues. The notch for cash assistance recipients arises from the sudden termination of medicaid benefits when recipients' income rises above the eligibility cutoff point. Consider a State where the estimated value of the medicaid health benefit is \$50 a month per family of four receiving aid to families with dependent children (AFDC). That estimate, medicaid costs divided by its eligibles, suggests that families are \$600 worse off annually when additional earnings make them ineligible for AFDC. At the eligibility margin, such families face a tax rate of almost 5,000 percent. Table 3 presents data on average medicaid costs in 18 States showing the potential seriousness of the notch problem.

TABLE 3.—*Annual income limits for medicaid benefits and annual medicaid cost per AFDC family for selected States*

State	Maximum income for initial eligibility for a medically indigent family of 4 ²	Average medicaid cost per AFDC family, 1970-71
California.....	\$3, 600	\$876
Colorado.....	2, 820	344
Florida.....	1, 606	334
Georgia.....	1, 788	394
Illinois.....	3, 600	908
Indiana.....	2, 100	553
Iowa.....	2, 916	692
Massachusetts.....	4, 176	738
Michigan.....	3, 696	700
Mississippi.....	(1)	89
Missouri.....	(1)	335
New Jersey.....	(1)	491
New York.....	5, 000	970
North Carolina.....	(1)	503
Pennsylvania.....	4, 000	610
Texas.....	(1)	640
Vermont.....	3, 828	668
Washington.....	4, 260	484

¹ State offers medicaid only to cash assistance recipients.

² Recipients of AFDC may receive full medicaid benefits as long as they receive any AFDC payment. Because of the various disregards and work incentive provisions in AFDC, working recipients may receive AFDC—and hence, medicaid—at total income levels well above those shown here.

Source: Col. 1. U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, Assistance Payments Administration, Division of Program Evaluation, "Income Levels for Medically Needy in Title XIX Plans in Operation, as of Dec. 31, 1971" (March 1972), and table 1.

Col. 2. Unpublished tabulation, Office of Assistant Secretary for Planning and Evaluation, Department of Health, Education, and Welfare, Mar. 16, 1972.

The notch obviously creates substantial incentives to avoid earnings which would make one ineligible for medicaid. But a different problem arises for "medically indigent" persons whose incomes are too high for cash assistance standards, but whose medical expenses reduce their disposable income below the State-set eligibility for the medically

⁸ U.S. Department of Health, Education, and Welfare, Social Security Administration, "National Health Expenditures, 1929-70," by Barbara S. Cooper and Dorothy P. Rice, *Social Security Bulletin*, XXXIV, No. 1 (1971).

needy (that is, no more than 133 percent of maximum payments for AFDC families of comparable size). Such families face indirect, 100-percent tax ranges on earnings above the eligibility level. Whatever that income level, they must "spend down" to become medicaid recipients; each dollar of additional earnings thus makes them no better off if they have medical expenses. The "spend-down" provision requires them to spend income about the eligibility level on medical expenses.

The vertical equity issue is apparent when one contrasts the conditions of *entrance* into medicaid with the conditions of *exit*. Families remain eligible for medicaid over the range between zero and the cutoff point described previously. That means there are low-income families whose income is above the entrance eligibility standard, but below the income cutoff who are not receiving medicaid subsidies. Families with equal incomes thus receive very different treatment depending on whether they first entered the medicaid program and then increased their income or if they never entered the program at all. It is this equity problem that often is referred to when contrasts are drawn between the treatment of nonwelfare and welfare families of similar incomes. And it is this feature of medicaid which could discourage recipients from ever leaving welfare.

The problem of this notch in real income has dominated much recent discussion of medicaid reform. But it is the cumulative tax rate issue that is central to reform proposals to reduce the value of the medicaid subsidy as income increases. Taking the previous example once again, one could treat medicaid as a \$600 a year insurance subsidy for a family of four and require graduated premium contributions that increased with income. If it were decided to maintain the existing medicaid eligibility cutoff points, the result would be a higher marginal tax rate on earnings for all current medicaid recipients and, of course, reduced benefits for many. To prevent present recipients from losing benefits would require a gradual reduction of the subsidy beyond the cutoff point; that would increase the number of medicaid eligibles dramatically, though the subsidy for the new eligibles would be less than \$600 a year and would drop farther as income increased.

The rate of premium contributions, of course, determines the tax rate on marginal earnings. No easy answer recommends itself. It seems inappropriate to require families with \$6,000 annual incomes to pay 10 percent of these incomes for medical insurance—which is what would happen if the cutoff point were \$6,000 for the medicaid subsidy assumed here. Such families might want to allocate their modest incomes in other ways. And it would worsen the marginal tax rates facing families as their earnings approached \$6,000 per year.

Some States have tried cost-sharing devices to lighten their financial burden from medicaid. Deductibles and coinsurance (often 20 percent of certain services) are employed for the medically indigent, thus making the categorical programs more attractive for families facing chronic illness and continuing medical expenses. The 1972 amendments contained in H.R. 1 permit deductibles and coinsurance for cash assistance recipients receiving certain optional medicaid services, and require premium payments for the medically indigent.

Valuing the medicaid benefits for purposes of considering work incentives raises some difficult problems. The common procedure is to ask what one would have to pay for the State's medicaid benefits if an insurance company were selling such a policy. The answer would

be total costs divided by eligibles; in the Michigan case, roughly \$600 a year for an AFDC family of four; in New York, \$1,000 a year. The difficulty is that families have very different probabilities of incurring average costs in any one year. For example, the aged have medicaid's highest average per-beneficiary expenditures, and nursing home charges represent a very substantial share of those expenditures. Should AFDC recipients be treated as if they are "buying" policies whose premiums reflect substantial nursing home costs they would in all probability never incur? One solution, perhaps, is to allocate costs to different age groups and estimate premiums for separate demographic groups. The theory of insurance requires spreading costs among enrollees; social insurance requires spreading them among larger groups than private insurance companies would cover. But spreading medical care costs among all medicaid recipients particularly overestimates the benefits which the nonaged poor receive from their medicaid "policy."

The argument also is advanced that such premiums overstate the benefits families receive from the "insurance" even when adjustments by age group are permitted. It proceeds from the assumption that poor people value medical insurance less than others because of more pressing claims on their income for food, shelter, clothing, and transportation. Thus, the insurance "premium" estimation procedure involves imposing a social decision about the value of insurance for poor people who might be expected to value income in cash higher than income in kind. One solution proposed by Martin Feldstein is to provide a lump-sum transfer equal to average expenditures and permit poor families to buy their own preferred insurance package. But the problem is that if they under-insure, face large medical bills and become destitute, public programs will finance their under-insurance. And that means those who insured themselves more adequately are treated unfairly.

However one values medicaid benefits, they vary substantially by region and type of location. First, as stated above, poorer States provide less generous medicaid benefits, even though they are more generously reimbursed by the Federal Government. Seventy percent reimbursement is insufficient to induce some Southern States to expand eligibility and benefits. One measure of this pattern, presented in table 2, is the higher rate of Federal participation in State medical vendor payments where the medicaid benefits are restricted to those receiving cash assistance. Note as well that of the 25 States without a medical indigency program, 11 are southern or border States. (Two western States have no program at all.)

The variations in coverage and benefits means that Federal medicaid expenditures are very unevenly distributed by State and region. As with the predecessor Kerr-Mills legislation, the largest industrial States dominate the medicaid program despite their lower rate of Federal cost sharing. Of the \$4.4 billion expended by medicaid in 1969, over half was spent in four States: New York, \$1.2 billion; Michigan, \$174 million; California, \$871 million; Illinois, \$169 million.⁹ Put another way, over 47 percent of the Federal expenditures

⁹ U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, Office of Program Statistics and Data Systems, National Center for Social Statistics, "Numbers of Recipients and Amounts of Payments under Medicaid and Other Medical Programs Financed from Public Assistance Funds, 1969," Mar. 1, 1972.

for medicaid went to two States—New York and California. Transfer programs that depend upon State spending, in the area of health, at least, appear to concentrate their benefits in the higher income States.

4. Method of Financing

The present methods of financing medicare and medicaid encompass the range of usual possibilities; social security payroll taxes, general Federal revenues, beneficiary contributions (premiums, deductibles, and coinsurance), and general State and local funds. Medicaid uses almost exclusively general revenue financing from Federal, State, and local treasuries, with the Federal Government contribution proportionately more to States with lower per capita incomes. As indicated in table 2, Federal matching percentages range from 83 percent in Mississippi to 50 percent in New York and other high-income States.

Looking at the Federal source alone, such financing means that medicaid is relatively progressive in its financing provisions. The State and local payments arise from a variety of tax sources and on balance may well have a regressive impact. Taken together, however, medicaid financing is almost certainly more progressive in its distributional impact than is medicare financing. As was made clear earlier, those tax sources differ for the two parts of the medicare program. Hospitalization insurance (part A) is financed by an earmarked part of the general social security payroll tax (0.6 of the 5.2 percent employee total tax). That tax, generally viewed as regressive in character, has been undergoing change in the 1960's as the wage base on which it is calculated has been increased rather dramatically. It is roughly estimated that the tax is proportionate up to about median earnings and takes a decreasing share of income above that level.

Physician insurance complicates the usual comparison of social insurance and "welfare" program financing. Politically speaking, the "price" of social insurance is the payroll tax, a regressive tax that has the advantage of giving beneficiaries the sense that they have "paid for" their benefits. It also gives the important illusion that such funds are protected and that medicare is not subject to the usual politics of yearly congressional review. It is these political benefits that favor trust-fund financing, not the "guaranteed" feature of the benefits.

This is apparent if one looks at the complicated financing provisions of part B. Beneficiaries pay half the monthly premium of approximately \$12, with general revenues financing the other half. In 1971, the Federal Treasury premium share amounted to \$101 million monthly. The mixture of deductible and coinsurance, applying to both parts of the program and too complicated to discuss here, amounts to a significant portion of the aged's total health expenditure. These cost-sharing features, combined with exclusions in the medicare benefit schedule, help to explain why nearly \$7.9 billion of Federal health expenditures for medicare amounted to less than half (43 percent) of the total medical bill of the aged,¹⁰ in 1970.

The medicaid financing scheme, while attractive in its distributional aspects, has the vices of its virtues. It is subject to yearly congressional

¹⁰ C. Kramer, "Fragmented Financing of Health Care," *Medical Care Review*, vol. 29, No. 8. (August 1972) p. 888.

review, and the resulting intense criticism, and the program has been cut back from its original benefit and eligibility scope. Whether uncertainties arise from the general revenue financing, or whether the clientele of the program explains medicaid's unsteady course, is difficult to tell. The cliché that programs for poor people are poor programs may well be true, although this cliché ignores the fact that medicaid provides far more generous benefits than medicare in most cases. Clientele may determine the political treatment of a program, not the character of the taxes that support it. Some support for this interpretation can be found in the medicare program; there is no evidence that the separate financing of physician insurance—and the failure to use the payroll tax for it—has made part B more similar to medicaid than to the hospital part of the medicare program.

Equity and tax theory considerations would argue against using payroll taxes in their present form to finance a large public medical care program. This issue will come up again when we discuss the Kennedy-Griffiths health insurance bill; its particular mixture of payroll taxes and general revenue financing has no particular rationale. And I would suggest here that one might favor a variation of the payroll tax if its entitlement and political attributes are sought. One could imagine a payroll tax expressed as a proportion of income tax liability that would provide the attributes of a separate trust fund but have quite different and desirable progressive distributional features. To avoid "free-riders," one could require a minimum payment each year, with a surtax on income tax liability as the main financing mechanism. That surtax, designed to finance current expenditures on a pay-as-you-go basis, would vary with the present expenditures of the system. It would have as much legal force as the present trust funds, which basically are U.S. Government promises to pay designated citizens certain sums of transfer payments.

All of these remarks stress the burdens entailed by financing forms of Government health programs. They do not try to deal simultaneously with the distribution of benefits. In health care there is a special reason for that; the insurance is the benefit, not just the health expenditures made on behalf of sick people. Any public insurance for medical care distributes benefits disproportionately to the sick if benefits are measured by expenditure patterns. There is considerable merit in separating the issue of what insurance one wants from how one wants the government to finance that package. And, in that financing choice, one must be explicit about the ideological and political benefits connected with social insurance programs and not be mystified about the causes of those benefits. Most citizens have no precise idea of the relation between contributions and benefits in social insurance; the notion of a separate fund, and the idea that contributions entitle one to benefits within the program is what gives social insurance its peculiar popularity advantages, rather than the precise wage base, taxing mechanism, or benefit ratios.

5. Cost-Sharing and the Problems of Integration

The rapid growth of medicaid—particularly in New York and California—has made cost control a dominant theme of the medicaid and general health insurance debates. Patient premiums, deductibles, and coinsurance/copayment all have been suggested as ways to reduce

the Government costs of medicaid and, in some instances, to change the incentives facing patients so that a more rational use of expensive component services would be encouraged. A similar concern about greater patient payment has emerged with medicare, though with less intensity and less surprise since it is already using the full range of cost-sharing devices.

Sharing costs obviously conflicts with the goal of removing the financial obstacles to care, though there is no agreement about the precise impact of different devices. Requiring premiums in medicare probably has meant that the largest proportion of the uninsured (for part B) are lower income aged.¹¹ This group is the potential user of income-tested medical assistance, whether medicaid, medical assistance to the aged, or charity medicine. For the aged, the pecuniary advantages of medicaid can be interpreted as being the difference between the medicare policy and the medicaid policy value; for particular aged person with illnesses requiring services medicare does not cover, the difference can be very large: monthly premiums, the deductibles and copayment, and the total cost of drugs, nursing home, and other uncovered services.

Increasing the cost-sharing within medicaid reduces the financial incentives to enter the program. But the devices themselves present problems for the cumulative tax rates present recipients face. Cost-sharing that does not vary with medicaid recipients' income reduces the value of the insurance "policy," retains (although reduces) the notch problem, but presents no special difficulties with increasing marginal tax rates. Varying the cost-sharing with income—and thus improving vertical equity among medicaid beneficiaries—presents both administrative and cumulative tax rate difficulties.

How great these difficulties are depends partly on how the cost-sharing is calculated. For potential users of medicaid-covered services, the insurance subsidy is reduced from the full "insurance premium" value. For actual users, there is the incurred financial burden which is not captured by actuarially estimating the declining value of the policy. For recipients with very different propensities to require medical services, the use of averages may not be helpful. One would also be interested in the distribution of losses incurred by increased earnings and hence higher deductibles, coinsurance, and copayments.

A nearly insoluble problem arises from trying to simultaneously introduce cost-sharing and hold present medicaid recipients harmless. To do so requires a full premium subsidy to the present cutoff point and a declining one (increasing premiums) above that figure. Consider a hypothetical State with a medicaid benefit value at \$500, a cash assistance cutoff point of \$7,000 for a family of four, no other income-tested benefits available except cash assistance, and a marginal tax rate of 80 percent. A medical premium reduction rate of 10 percent, applied only to income above \$7,000, requires a cutoff of \$12,000. Thus, roughly half the people in a typical State would become eligible for some medicaid benefits. To have the premium subsidy disappear at the cash assistance cutoff point would make all present recipients worse off, increasing their cumulative tax rate by less than 10 percent. Present suggestions for reforming medicaid through cost-sharing all suffer from this defect. The answer of the

¹¹ "Medicare: Number of Persons Insured," *op. cit.*

Nixon administration—that welfare reform would have simultaneously increased the cash income of many of the poor—would not have been valid for those States whose cash assistance levels would not have been preempted by H.R. 1.

6. Program Interactions

To what extent are medicare premiums paid by State medicaid programs? What are the equity implications of this arrangement? By July 1970, there were nearly two million public assistance recipients enrolled for medicare's supplementary medical insurance under welfare "buy-in" agreements; only five States, Alaska, Arizona, Louisiana, Oregon, and Wyoming, were then not participating.¹² Participating States alone finance the enrollee premium for aged persons in the medically indigent category. For regular old-age assistance recipients, States share the premium cost with the Federal Government under the usual Federal medicaid matching. The consequence is that medically indigent aged are more expensive to the State than are old-age assistance recipients.

The interaction between medicaid and medicare, as a matter of Federal policy, is fiscally encouraged. From January 1970, Federal matching was no longer available for any expenditures for medicaid services that would have been financed by medicare if the patient had been enrolled in the supplementary medical insurance program. How much fraudulent billing has occurred as a result is difficult to estimate precisely. In its 1970 review of medicare and medicaid, the Senate Finance Committee concluded: "A medicaid fraud and abuse unit should be established in the Department of Health, Education, and Welfare in order to facilitate and coordinate both State and Federal efforts toward the prevention or discovery and prompt investigation, prosecution, and other followup activities designed to curb and punish fraud and abuse." The committee cites instances where a medicare fraud case also involved medicaid but where there was no investigation to determine the legitimacy of the medicaid claims. It recommends specific organizational units at the State level for the prevention, detection, and investigation of abuse and fraud in State health care programs.

PART II. INTEGRATING PROGRAMMATIC REFORMS IN WELFARE AND MEDICAL CARE

Part I has raised a number of program integration issues in connection with the current operation of medicare and medicaid. This section will focus on issues of equity and combined tax rates that arise when welfare reform and medical care reform are considered simultaneously. For purposes of discussion, we will restrict comment to a pair of welfare reform plans and a pair of medical care reform plans. Discussion will proceed by examining the issues raised for each welfare reform plan by each of the medical care proposals.

Before proceeding, a brief characterization of the welfare and medical care plans to be discussed is required. The negative income tax example is the Nixon administration's welfare reform plan em-

¹² "Medicare: Number of Persons Insured," *op. cit.*

bodied in the House-passed version of H.R. 1 (92d Cong.). Restricted to families with children, the plan combines a modest income guarantee (\$2,400 a year for a family of four) with a tax rate within the cash program of 67 percent. The second welfare reform is a demogrant plan which combines a universal tax credit of \$1,200 a year per adult and \$600 per child with a general proportional tax rate of 33 percent. Put differently, we have two income redistribution plans of a negative income tax type: one guaranteeing \$2,400 for a family of four; the other, \$3,600 for a two-adult family of four. The former restricted to families with children; the latter universal. The former reducing benefits as income increases at a two-thirds rate; the latter at a one-third rate. The former requiring additional Federal outlays of \$5 billion; the latter requiring extensive tax reform to finance its greater cost.

The two medical care plans are variants of national health insurance. The more familiar is the Kennedy-Griffiths proposal (H.R. 22 and S. 3, 92d Cong.). Universal in eligibility, the plan provides comprehensive benefits including almost all medical expenses except "cosmetic" care. Financed by a combination of Federal payroll and income taxes, the H.R. 22 scheme eschews income-testing and any significant use of cost-sharing devices. In effect it would direct almost all health care expenditures through the Federal Government. The Social Security Administration estimated that the plan would require \$91 billion of additional Federal expenditures in 1974, representing at least a 20 percent increase in total Federal taxes at estimated 1974 levels. There would, of course, be savings of out-of-pocket expenditures on health which individuals now make.

The other national health insurance scheme under discussion is the catastrophic plan proposed by Prof. Martin Feldstein. Known as major risk insurance (MRI), it proposes universal, comprehensive national health insurance with a large income-related deductible. Feldstein proposes a deductible of 10 percent of annual family earnings, thus protecting all citizens from extraordinary health expenses but retaining private payment for most health care use. Feldstein suggests special treatment for families below the poverty line, which we will ignore here. Such a plan, Feldstein estimates, would involve annual expenditures of \$10 to \$12 billion.

1. H.R. 1 and H.R. 22

Such a combination does not raise difficult problems of integration. The health insurance scheme's exclusion of means-tested benefits avoids cascading cumulative tax rates. Universal coverage in the health plan avoids the horizontal inequities of the present medicaid-welfare combinations. The comprehensiveness of benefits assures that health expenses will not be a cause of impoverishment. But two problems remain. The first is H.R. 1's high marginal tax rate of 67 percent, a potential problem for work incentives in and of itself. The second is the large tax increase the H.R. 22 health plan would require. Unless that tax increase is received exclusively from non-H.R. 1 beneficiaries, the income tax rates of some welfare families who are working would have to be increased substantially. Of course, any increase in taxes to finance this plan would replace current personal health expenditures, and thus would not involve new payouts for many taxpayers.

2. H.R. 1 and Major Risk Insurance

The universal eligibility of MRI, as with H.R. 22, avoids horizontal equity issues. MRI's deductible of 10 percent of income means that increases in earnings of H.R. 1 recipients above the poverty line would be subject to an increasing marginal tax rate of a relatively small magnitude. Were H.R. 1's basic tax rate below 50 percent, this increase of no more than 10 percent would not be serious. As it is, any addition to a 67 percent tax rate imposes tax rates on H.R. 1 recipients that are higher than the rates anyone else in the society is required to pay under the positive income tax. The adequacy of MRI's health benefit is, of course, a separate, but serious issue.

3. Demogrant and H.R. 22

This combination, considered apart from other income-tested programs, does away with the problems of high cumulative tax rates and vertical and horizontal inequities. The universal eligibility, combined with the demogrant's tax rate of 33 percent, and the health plan's exclusion of income-testing, produces this result. Yet one can say this only by looking at the combined administration of benefits. If one turns to the financing of such an expensive combination—requiring tax increases of perhaps \$100 billion—the problem of marginal tax rates reappears, shifted from the low-income population to the population at large. These funds can be raised only by levying additional taxes on those above the demogrant's break-even point (\$10,800 per year for a family of four). This combination, then, minimizes problems of integration at the price of raising serious difficulties in allocation of very substantial income tax increases. It thus requires substantial tax reform in the treatment of middle- and upper-income families.

4. Demogrant and Major Risk Insurance

This combination has most of the features of the preceeding one with two major exceptions. The fact that MRI has an income-related deductible means that a marginal tax rate addition of up to 10 percent applies to increased earnings. But this is less serious for a demogrant with a low proportional tax rate than for an H.R. 1 plan with a high marginal tax rate. Excluding all other considerations, the combined plans would entail tax rates below 50 percent for recipients. The other difference is the lesser expenditures which MRI would entail, perhaps one-sixth the burden of the H.R. 22 plan. MRI involves tax reform as well as tax increases. As with H.R. 22, MRI proposes abolishing the present tax deduction of medical expenses above 3 percent of income.

Conclusion

The problems of the MRI and the Kennedy-Griffiths health care plans at bottom are not ones of equity, cumulative tax rates, or adequacy. Rather, they concern resource allocation, tax burdens, and efficiency which fall outside this paper's scope. MRI removes the financial barrier to very expensive care and, according to critics, subsidizes costly care at the expense of encouraging preventive care. In fact, both plans require a social choice about the distribution of expensive treatment; regulation would have to substitute for the

role financial means (including insurance) now plays in deciding who lives when the price of maintaining life is dear. Rationing these health resources under MRI would be public and visible, and, one hopes, fair. The H.R. 22 plan raises similar rationing problems by fixing a national health budget, but the rationing would be required over a larger range of services than MRI. These brief remarks are not meant to foreclose discussion but to suggest that while program integration problems may be lessened or even eliminated by universal health plans, other critical issues remain to be resolved. Furthermore, even if cash and medical care programs are reformed with respect to marginal tax rates, other programs, like housing and day-care subsidies, still add to marginal tax rates when their benefits decrease with family income.

Another issue of importance not dealt with extensively in this paper is the complexity of administering cash assistance and health care programs. Of the health care plans considered, H.R. 22 is the most simple administratively for beneficiaries, but it is complex in the type and amount of provider regulation it would entail. Its combination with the demogrant would be the least complex arrangement, but would entail Federal expenditures of more than a \$100 billion. The MRI-demogrant combination would be less cumbersome administratively than the MRI-H.R.I. alternative, but at considerably increased Federal cost.

Comparing the two health alternatives alone, it appears that MRI is somewhat more complex for beneficiaries, but less so for providers of health care. However, this conclusion rests on the assumption that the Treasury would administer MRI as it now administers the deduction for health expenses of more than 3 percent of taxable income, using a credit rather than a deduction device to determine governmental fiscal responsibility. All such administrative assessments are subject to a wide margin of error and are included here to open the issue for further discussion.

DAY CARE: NEEDS, COSTS, BENEFITS, ALTERNATIVES

By VIVIAN LEWIS*

SUMMARY

Day care is related to welfare and welfare reform in several crucial respects. First, some portion of child care costs is subsidized now by the Federal Government through deductions from income under the Federal personal income tax; through deductions from earnings in computing public welfare benefits such as Aid to Families With Dependent Children (AFDC), public housing, and food stamps; and through child care facilities subsidized directly by Federal, State, and local funds. Each of these methods means that families pay less for child care than they otherwise would and/or that their public welfare benefits (such as food stamps, public housing, and AFDC) are larger than they otherwise would be.

Second, under subsidy methods that scale down child care subsidies as income rises, the net gain from employment is reduced. In conjunction with other income-scaled benefits such as welfare cash supplements, the net gain from added earnings can be so small as to constitute a work disincentive.

Third, if cash welfare benefits depend upon meeting the conditions of a work or job search requirement, a case can be made that the Government must assure that child care is available.

Finally, current provisions for reimbursement of child care expenses under AFDC are inequitable in that working women never on welfare must make their own arrangements for child care. Generally they are eligible only for indirect partial subsidies through income tax deductions for child care. Reform of the cash welfare programs thus require reform of child care subsidies as well. For these and other reasons, day care considerations become an integral part of efforts to better coordinate the Nation's proliferation of public welfare programs.

The type of day care discussed in this paper involves the provision of supervision, meals, and services necessary for good health and normal development to children aged around 3 to 6, for at least 8 hours per day, at least 5 days per week, on a year-long basis. It is this full-time care for preschoolers that presents the most difficult prob-

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lems, both financially and emotionally, for taxpayers and for the families themselves.

Data relating to the demand for day care are seriously flawed, and their limitations should be emphasized. However, critically considering those data that are available leads the author to conclude that the unfilled day care need is not as great as it has been pictured, and that even if day care is made available, it will not be used to the fullest capacity by all potentially eligible parents, especially if it is in day care centers.

Day care is expensive and Government-regulated day care even more so, but at present Government regulation applies to only a minority of the children being served. Day care appears to cost parents marginally over \$1,000 per year per child in day care centers, and something between \$700 and \$1,100 in family day care homes in which someone, generally a woman, looks after no more than six or seven children. Many children are looked after for free, or for noncash gratification, the cost being borne by the care-giver. Fees charged often do not take full account of real costs, with care-givers and society setting a low price on their services, in part because of noncash gratification.

It is argued in this paper that developmental care cannot be said to exist only in day care centers, or in expensive programs requiring high staff qualification and low staff-to-child ratios. Developmental day care is difficult to define anyway, because even high-priced standards for care do not necessarily mean that development in fact is being encouraged in any meaningful or lasting way. Such standards apply to only a tiny minority of the children now receiving care. Supplementary benefits to children in day care are provided inefficiently and inequitably, such as in the case of food and medical components of care. It was found that other services one might expect day care to provide generally are not being provided, among them transportation to and from the day care situation, care for all hours needed, care of sick children, and inoculation against communicable diseases the children are exposed to in the day care situation. This is especially true of care in day care centers.

The current targeting of the largest day care subsidies on welfare recipients is shown to result in inequities against women already working, women living with their husbands, or women not on welfare seeking work. The attempt to limit costs of an expanded day care-center program by targeting it on a welfare population would serve to reinforce existing inequities. Any program requiring welfare mothers to work, and providing day care only to them, will suffer from these results of targeting, although there may be social benefits resulting from greater work force attachment for the mothers. Only very low cost care, which may be dangerous for children and ultimately to society, if provided through non-homelike situations (such as centers which, if reasonably staffed, are expensive) will be able to reduce the short-run costs of welfare programs.

Corporate forms of day care, subsidized by employers or provided by a company in the day care business, involve high costs where the care is provided in centers. In the case of family day care homes, which are at least theoretically run as a business, there are certain real benefits to the child and his mother: they are often cheaper than center care, hours are more flexible, and so forth. On the other hand,

expanding these programs by direct Government intervention does not appear to preserve all the benefits, and would likely increase costs. While the data are inconclusive, it appears that many of the costs of family day care homes are borne by the care-giver, who typically does not include the cost of equipment, rent, and other costs in setting her fees. Family home care costs would be higher under Government sponsorship because of the effect of applying minimum wage laws.

Next, inequities in the existing AFDC work-expense allowance covering day care are discussed. It is noted that this form of day care subsidy will come into increasing use now that triple-matched funds under Title IV-A of the Social Security Act are no longer available to States for day care on an "open-ended" basis. The problematic features of the day care deduction under current tax law are also discussed. A proposal for the establishment of a tax credit or voucher system is considered, and two problems with it are described in some detail; namely, assuring an adequate supply of care-givers (family day care mothers) and child care facilities in the context of a free market system, and the more important issue of how to control the quality of care provided in a system based on free parental choice. Parental education is needed in the choice of day care alternatives. Under a voucher or tax credit, parents could be required to report the reasons for changing the kind of day care situation chosen in order to provide an indirect quality control. Reducing monetary constraints to adequate care by a voucher system should be a good method of increasing parents' ability to reject poor care, and is viewed as more effective than existing methods for policing, licensing, and controlling day care in the family context.

The following legislative changes are proposed:

(1) To offer a tax credit for day care expenses to families with children, and with all adults working, which do not use the existing or proposed tax deduction.

(2) To allow eligible families using the standard deduction and eligible families at all income levels (even above the current ceiling) to use the current day care deduction, however reducing the maximum deductible amount.

(3) To replace the current AFDC work expense credit with a deduction that is a specific percentage of earnings.

While these proposals would all be desirable as part of a reform of day care subsidies, any one can stand on its own. However, instituting (3) without (1) would significantly increase the burden on AFDC recipients of child care expenditures.

BACKGROUND

There was an old woman who lived in a shoe,
 She had so many children, she didn't know what to do.
 She gave them some broth,
 Without any bread,
 She whipped them all soundly and sent them to bed.

What Is Day Care?

Most surveys tend to treat day care as if it is a single commodity, a single package of goods and services. This approach fails to recog-

nize the wide variations in the type of care or its quality—a feature which may bear little relation to how much is spent on it. It also confuses the issue by not differentiating between children of different ages. It is obvious, for example, that parents are more reluctant to use day care arrangements (especially centers, but family day care homes and babysitters as well) when they are for infants and toddlers than when they are for children over age 3. Yet most of the opinion poll studies of the need for day care have failed to make this simple distinction on the basis of the child's age.

For the purposes of this paper the day care discussed involves the provision of supervision and meals and services necessary for good health and normal development to children aged around 3 to 6 for at least 8 hours per day and at least 5 days per week on a year-long basis. Only this kind of care would meet the child care needs of the working mother in a full-time job with regular hours. The scope of this paper leads to the omission of programs like Head Start, public nursery schools and kindergartens, and cooperative babysitting pools, none of which generally provides anything like 40 hours per week of care. While not all mothers using day care need the full 40-hours-plus coverage used to define day care here, anything short of it will be insufficient for the bulk of working mothers, given the time needed to travel to work and back.

Day care can be provided in the child's own home, in someone else's, or in a group care center. The person providing the care may be related to the child or not and may be paid or not. The center may be profitmaking or nonprofit and may be paid for by the parent(s) or a third party (employer, voucher fund, welfare office, some other government agency), directly or indirectly.

Who Gets Day Care?

It should be noted that there is no clear consensus for excluding babies and toddlers from the day-care population. While there is a strong body of evidence that 24-hour institutional care is dangerous to children, especially babies, the recent literature of psychology has been toying with various alternatives to maternal care. According to the overwhelming bulk of this literature, young children (those under 3 mainly, but not exclusively) should be reared in a homelike atmosphere, having a relationship with a single maternal person. Providing such care for 9 hours per day so the mother can work full time is extremely expensive: the mean cost of family home care (in someone else's home) for a full day for infants (0–18 months) has been calculated at \$2,625 per child, and for toddlers (19–35 months) at \$2,122. These figures cover only a minimum wage to the care-giver and the food the baby requires, with no allowance for quarters, overhead, supervision, maintenance, health services, or even diapers.¹ However, parents in fact pay substantially less for such care, as will be seen in subsequent sections of this paper.

¹ Derivations by the author from index data for 30 cities, giving the costs of meeting the 1972 Federal day care standards, prepared by Donald G. Ogilvie, *Estimated Costs of the Federal Day Care Requirements*, submitted to the U.S. Department of Health, Education, and Welfare, Office of Child Development (Washington, D.C.: Inner City Fund, 1972), p. 16. A discussion of the omissions in the calculations will be found in the final section of this paper.

While there can be arguments that the standards set for such care are too high, there are real dangers in attempting to cut costs by increasing the number of infants per staff member. Since the cost of day care for this age group is made up of staff salaries to such an extent (85 percent for the infants, 79 percent for the toddlers), reducing costs would mean increasing the number of children per care-giver. This raises the specter of "marasmus" and "institutionalism," two forms of physical and mental retardation caused by full-time impersonal care of very young children. It should be recalled that stunted intellectual and physical growth can be shown to have been caused in children by institutionalization for all of their waking hours. For very young children, who would sleep for most of the 15 hours that they are not in the day care situation, this danger would have to be considered.

A spate of research over the past decade or so has attempted to challenge the relevance of studies of maternal *deprivation* to the now far more current issue of maternal *separation*. When such research focuses on the outcome of specially designed, high quality (and very high cost) day care facilities, it is not highly relevant to a decision to set up a general program. Much of the research also suffers from inadequate or poor statistical controls.

Recent research seems to have found little or no difference in adjustment and behavior of children between working and nonworking mothers, with the studies focusing largely on school-aged children. On the other hand, attempts to determine the consequences for pre-school children of intermittent separation from their mothers have neither proven nor disproven that, beyond reasonable doubt, there is cause for concern.²

Doubts and fears about the dangers to very young children of prolonged separation from their mothers are too widespread to be laid to rest by partisans of infant day care, particularly when there is little data available and the programs for dealing with these children have been so exceptional as to probably be irreproducible on a massive scale.

Given the very small size of the studies done in the United States to date, and the rather exceptional arrangements made for the care of these babies,³ most advocates of universal day care centers have cited various programs abroad to support their case. There has been some experience with children under 3 in day care centers in Poland, Czechoslovakia, France, and the Scandinavian countries. In this country, there has been some experience (before the most recent experiments) with the World War II programs and in the *kibbutz*-like child-rearing practices of some Mennonite sects. It is obvious that some children can manage institutional day care at 2½ (just as some 3- or 4-year-olds cannot manage the emotional demands of a group situation). But to generalize a program that would have to be very expensive, we would have to be sure that the majority of the target population would be better served than if they were cared for by their mothers or babysitters. At this point, such assurance cannot be offered.

² Alvin A. Schorr, *Poor Kids* (New York, 1966), p. 62.

³ See Bettye M. Caldwell, et al., *Infant Care and Attachment* (Syracuse, N.Y., 1969). This is a study of 41 infants of the children's center who were in care from the ages of 6 months and up, and who were tested by psychologists and found normal.

It frequently is assumed that foreign experience with pre-kindergarten age groups has been far more extensive and far more widespread in the population served than it in fact has been. The under-3 year olds enrolled in publicly arranged day care in Denmark, the industrialized Western country with the highest such enrollment, totaled only 20,000 children in 1972, double the enrollment of 1967. Half were in family day care arrangements, not in centers. There is a heavy demand for day care, which has resulted in waiting lists of 14,000 children, some as yet unborn! As a result, the Danish townships which initiate, control, and often (indirectly) finance family day care of under-3-year-old children have excluded virtually all but those with high development risks; that is, children who are illegitimate, from broken homes, from homes where pathological conditions exist, where the parents are low-income, students, or ill, or where the child is handicapped or has a behavior problem.⁴

Eastern European experiences involved larger numbers of under-3's; Czechoslovakia once enrolled 74,000.⁵ However, both the Czech and Polish programs apparently are being phased out. In France and Sweden, a tiny minority of pre-school children are provided with full-day care in centers, and, as in the much larger Danish program, the existence of large waiting lists has confined eligibility to problem children, usually with unmarried mothers. These institutions, which also exist on a miniscule scale in England, are called "creches." The overwhelming majority of preschool-aged children attend nursery school part of the day. Only in France is it normal for most 2-year-olds to be admitted to the public nursery school "full time" if they are out of diapers and there is family need. These institutions are called "ecoles maternelles communales."

However, their hours, 8:30 to 11:30 a.m. and 1:30 to 3:30 p.m., with Wednesdays off, are not encouraging to regular maternal labor force participation.⁶

In France, some 10,000 children are in day care centers, or creches, most of them in Paris. They are cared for by "nurses," who are girls who have had puericultural training in lieu of high school studies, and who are not nurses in the English sense of the word (the French word "nurse" is best translated as "nanny".) Here is a report on creches in Paris:

The creches are open from 7 a.m. to 7 p.m., six days a week. The average creche accommodates forty to sixty babies. The quality of care varies considerably from one creche to another. * * * In one poor neighborhood, where both crowded conditions and adverse attitudes are in evidence, babies were kept all day, except for feedings, in the bassinet-like cribs, side by side, with crib covers occluding observation of anything but ceilings and a few hanging toys. * * * the nurses were afraid to handle the babies because they might accidentally become bruised and the parents would complain. They were afraid to let the babies play on the

⁴ Marsden G. Wagner, M.D., "Family Day Care in Denmark," prepared for the U.S. of Health, Education, and Welfare, Office of Child Development (unpublished, 1972).

⁵ Alfred Kadushin, ed., *Child Welfare Services: A Source Book* (New York, 1967), p. 568ff.

⁶ Author's experience in Paris, 1968-71; Kadushin, *Child Welfare Services*, p. 568; Edith H. Grothberg, ed., *Day Care: Resources for Decisions* prepared for Office of Economic Opportunity, Office of Planning, Research and Evaluation (Washington, D.C., 1972), p. 10ff; and Donald G. Ogilvie, *Employer-Subsidized Child Care*, prepared for the U.S. Department of Health, Education, and Welfare (Washington, D.C., Inner City Fund, 1972), p. 185ff.

floor for the same reason, although the limited floor space was inadequate for babies to learn to crawl. * * *

The babies themselves "adjust", and accommodate amazingly well to the systems they encounter. For example, when the mother brings her baby in the morning, undresses him, hands him to the nursing assistant, and leaves, there is rarely any sign of separation concern in the baby unless the mother "hangs around" * * * The babies are hugged and then placed on a potty by the nursing assistant when they are received from the mother. A few years ago, despite strict regulations prohibiting such premature attempts, the caretakers in some creches started a baby on the potty as early as three months of age, tying his shirt to a pole to support him in a semisitting position. Babies under a year may sit complacently on the potty for ten to twenty minutes having been given a cookie or a toy to hold their attention until their turn to be bathed or dressed in clothing provided by the creche.⁷

It might be argued that the stifling atmosphere in the French creches arises because of financial restraints and because of a certain amount of prejudice on the part of the nurses against the parents, usually unmarried, lower-class women. On the other hand, the institutional setting itself may be a contributing factor to the tolerance of care-giver behavior described in the quoted passages.

The only programs anywhere in the world which have chosen to cover *all* babies under 3 in a full-day center-type care situation are those used by closed agrarian groups like kibbutz members in Israel and certain religious sects in this country. There is good reason not to argue from the experiences of these institutions that center day care for babies is socially desirable for the U.S. population as a whole or for the children of low-income working mothers or for any other large group. Studies of the kibbutz have pointed out the importance of free hours during the working day when children are with their parents, a situation difficult to replicate in a nonagrarian work day. It is also known that kibbutz children's house "graduates" are not "normal" in the context of Israeli society, especially in their peer group relations, although their abnormality may be desirable to the kibbutz system.⁸

In a recent survey of day care centers in Chicago, it was found that although 42 percent of the centers admitted 2-year-olds as a general policy, they accounted for only 5.8 percent of the enrolled children. For comparison, 6-year-olds (who are not normally considered day care eligibles) were accepted by 50 percent of the centers, and accounted for 15.6 percent of the enrollment. Parents are reluctant to send very young children to centers even when they are accepted.⁹

On the other hand, it has been recognized recently that there are more 6-year-olds in day care than anticipated, largely children who turned 6 after the cutoff date for admission into the first grade in their locality. This recognition, which has been stressed by Donald Ogilvie of the Inner City Fund, led the Office of Child Development of the Department of Health, Education, and Welfare to include this age group in cost analysis in 1972 for the first time.

⁷ Caroline A. Chandler, Reginald S. Lourie, and Anne DeHuff Peters, "Early Child Care: The New Perspectives," in Grothberg, *Day Care: Resources for Decisions*.

⁸ Bruno Bettelheim, *The Children of the Dream* (New York, 1969) and also Urie Bronfenbrenner, "The Dream of the Kibbutz," *Saturday Review*, LII, No. 38 (Sept. 20, 1969), p. 72.

⁹ Jean E. Bedger, et al., *Findings: Day Care Cost Analysis Project*, Council for Community Services in Metropolitan Chicago (Chicago, Ill., 1972), p. 60f.

Are Day Care Programs a New Idea?

In 1788, the town of Hamburg, Germany, adopted a far-reaching welfare reform program that subsequently was copied elsewhere and which has a surprisingly modern ring. It was funded by weekly collections taken from all the inhabitants of the Hanseatic city by citizens taking turns. Doctors determined whether applicants for relief could work, and those declared employable were put to work, men cleaning streets, making rope, and repairing roads, and women and children spinning flax. Needy families received allowances whether or not they worked, and children also received allowances for attending school. Nurseries were arranged to care for children if the mothers were required to work.¹⁰

The first day care center in this country was established in 1854 in a hospital in New York to serve the children of employed female expatriates, who were looked after by the nurses. The first permanent day nursery was set up in 1863, to care "for the children of women needed to manufacture soldiers' clothing and to clean in hospitals."¹¹ After the Civil War it continued to receive government funds to care for the children of war widows seeking employment.¹²

The first major Federal involvement came under the Federal Emergency Relief Act, passed during the New Deal in 1933. FERA authorized funding of emergency nursery schools to provide work for women on relief and to serve children of poor families. Child services received further support in the original Society Security Act of 1935 (title V), and under the Works Progress Administration (1936) when another \$6 million was granted to provide jobs for women. At its peak, the New Deal program funded 1,900 day care centers serving 75,000 children, and additional programs for day care were run by the Farm Security Administration and the Federal Housing Administration, which provided construction funds. Services were extensive but educational programs were not included:

The children were given a daily health inspection and necessary medical services in addition to well-balanced meals, play, and rest in an environment conducive to normal development.¹³

Public support for day care in this country has tended to follow the national need for women workers, or the national need for jobs for women. As the United States geared up for World War II, a manpower shortage developed; womanpower was called in to fill the gap. Over 3 million married women, many with children, entered the labor force. Their symbol was Rosie the Riveter. Various stop-gap day care programs culminated in the 1943 Lanham Act, which provided \$51 million in Federal funds for the construction and operation of day care centers to serve the children of mothers employed in

¹⁰ Paul A. Brinker, *Economic Insecurity and Social Security* (New York, 1968), p. 17.

¹¹ Kadushin, *Child Welfare Services*, p. 3. Hospitals have remained day care pioneers.

¹² Irving Lazar and Mae F. Rosenberg, "Day Care in America," in Grothberg, ed., *Day Care: Resources for Decisions*, p. 61.

¹³ Works Progress Administration, *Final Report on the WPA 1935-43* (Washington, D.C., 1944), p. 62.

industry for the war effort. Over 3,000 centers were built, and at peak use in 1945 there were a total of 1.6 million children enrolled.^{13a}

By 1946, their funding cut off, most of the day care centers had closed, since parents were unwilling to pay for them, and few mothers continued to work. In California, where industrialist Henry Kaiser set up one of the most advanced day care programs for shipyard workers, and where other programs seemed particularly successful, the State education authorities kept the system going. However, the Federal Government is only just beginning to match its earlier effort in this area. In 1972, the total number of children in federally financed day care (including in-home and family care, after-school and summer programs, and part-day Head Start) was close to the 1945 level, at under 1.7 million.¹⁴ The U.S. population has increased by 40 percent since 1945.

SUPPLY AND DEMAND

I set off with my basket to Linkey Town at 8.
Home again, home again, market is late.
I set off with my basket to Linkey Town at 1.
Home again, home again, market is done.

Is There Much Demand for Federally Financed Day Care Centers?

There is no doubt that some children need day care, and that the Federal Government in some cases is the best agency in our society to provide the funds. The common argument for the expansion of Federal day care programs is that there are over 5.6 million children under 6 with working mothers and less than 700,000 licensed day care slots to serve them.¹⁵ It frequently is argued, furthermore, that deprived children, migrants, members of racial and linguistic minorities, and so on, would be better off in Government day care centers than in their own homes. There are some 3 million children under 6 in these categories. Another 1.8 million pre-school children are in families on welfare (Aid to Families with Dependent Children, or AFDC). Naturally, there is great overlap among these categories, but one is left with the impression that many millions of children are in need of day care.

This reasoning fails to distinguish among children by age and by duration of need for care. Gross population statistics cannot be used to define a programmatic need. Children of different ages in varying family circumstances cannot be lumped into a single day care basket.

A search for indicators of the real demand for day care leads to the consideration of interview responses given by nonworking mothers. The most frequently quoted of these studies, the 1970 *Day Care*

¹⁴ U.S. Congress, House Committee on Education and Labor, *Comprehensive Child Development Act* (H.R. 6748), 92d Cong., 2d sess., 1972, p. 21. The figure includes care indirectly financed by AFDC deduction, and Head Start and pre-kindergarten programs which often are part-day.

¹⁵ U.S. Department of Labor, Bureau of Labor Statistics, *Special Labor Force Report: Children of Working Mothers, September 1972* (Washington, D.C., 1972), p. 4; Committee on Education and Labor, *Comprehensive Child Development Act*, p. 6f. These sources cited for figures only. The arguments are all-pervasive.

^{13a} Of which the author was one.

*Survey*¹⁶ is also most frequently misquoted: the responses of a national sample of nonworking mothers whose family income was under \$8,000 showed *not* that 18 percent of them reported day care problems, but that day care problems were 18 percent of the total reasons given for not working. Since multiple responses and nonresponses were allowed, it is unfortunate that this misreading of the results is so widespread.

In fact only 13 percent of the Westinghouse respondents (10 percent of the total sample) cited problems in finding satisfactory or affordable day care.

The published reports of the Westinghouse study included no results from the question asked of nonworking parents in the household survey: "if satisfactory day care that you could afford was available, do you think you would look for work?"¹⁷ It can be presumed that response data were considered unusable for some good reasons suggested by our analysis of the responses.¹⁸ We learned that 38.7 percent of the mothers not now working indicated that they would look for work if satisfactory day care they could afford was available. However, mothers who had indicated on earlier questions that they had day care problems were only slightly more likely to plan to seek work than mothers who had indicated that they were not working on preference grounds.¹⁹ Of the respondents who said they would seek work if satisfactory, affordable day care were available, 22 percent had cited day care problems in response to earlier questions, and 18 percent had indicated that they were not working on preference grounds.²⁰

Similarly peculiar results arise in the analysis of responses of women who said they are planning to seek work within the next year. This subgroup (compared to women already seeking work and those not planning to seek work) was most enthusiastic about seeking work if affordable, satisfactory day care were available. However, that is

¹⁶ Westinghouse Learning Corp. and Westat Research Inc., *Day Care Survey—1970*, prepared for the Office of Economic Opportunity, Evaluation Division (Washington, D.C., 1971). Unless otherwise stated, all citations are from vol. I, *Summary Report and Basic Analysis*. Quoted figure on p. 174.

This was a carefully researched study somewhat carelessly presented, above all in the failure to distinguish between the various samples which change from section to section. Hence misreadings like the one noted are likely. The cost data on centers which will be discussed later appear to be given extra validity by the use of weightings derived from the Westinghouse data to predict the costs of a type of exemplary center which was not included in the study, according to William R. Prosser of the Office of Economic Opportunity.

However, the cost data on family day care homes are distorted by the method used to create a sample of such facilities. The sample was derived first of all by neighborhood canvassing, in which case little usable cost data were available from the survey. More comprehensive questions were put to family day care operators who were located by use of lists of day care facilities available. But, the family homes sample was generated by a size limit in defining centers or family homes (namely, whether fewer than seven children were enrolled), which may have skewed costs upward.

¹⁷ *Ibid.*, II, Questionnaire E, p. 49ff, "Non-working" question 11.

¹⁸ An analysis of the response to this question was prepared for us by Jack Ditmore and William L. Prosser of the Office of Economic Opportunity, for which agency the study was made. They are responsible for the numbers, not the analysis, which is the responsibility of the author. I am grateful for their assistance.

¹⁹ The questions relating to preference were: "I prefer not to work while children are young," and "I'm not interested in working."

²⁰ Sample of nonworking mothers who answered "yes" to "Non-working" question 11, given earlier in this paragraph.

not too surprising, considering that they already had indicated that they wanted to seek work. This group was far more concerned with finding *satisfactory* day care than with finding *affordable* day care.

Explaining these results, it can be argued that the subset of non-working mothers with day care problems and the subset of mothers who prefer not to work in fact overlap more than the published *Survey* results indicate. Similarly, the subset of mothers planning to seek work within the next year and the subset of mothers who would seek work if day care were available also overlap. In the first case, day care problems may be a *rationalization* for preference *reasons* for not working which are perceived by respondents as not socially acceptable. Secondly, women who are not working or planning to work may have decided to remain at home because of day care problems or their perception of possible day care problems which they perceive of as preferences for remaining at home. When offered a hypothetical solution to their day care problems, their preference for remaining at home turns out to be weak in many cases.

Women planning to go to work during the next year were doing so despite their perceptions of day care problems, which more often involved lack of satisfactory rather than affordable care, although these two response groups may overlap. Whether they already have made tentative day care plans,²¹ or they are confident (or overconfident) that they can solve their day care problems is unknown. On the other hand, providing day care they can afford but which may not be wholly satisfactory may cause these women to plan to seek work. Or these women may have selected themselves to go to work because they can afford more money for day care, or because they are less troubled by cheaper forms of day care, or because they are less concerned with their children, or bored with child-rearing, or convinced that they are inadequate child-rearers.²²

In two other recent studies, families potentially eligible for assistance under welfare reform proposals were surveyed as to their day care needs. One study surveyed families in Vermont potentially eligible or nearly eligible for the family assistance plan (FAP as embodied in H.R. 16311, 91st Congress). Thirteen percent of the entire low-income population of mothers who were unemployed or working in the home said they would seek work if day care were made available.²³

²¹ Once again it is regrettable that the *Survey* failed to report the ages of the children of the surveyed parent.

²² A recent analysis has sorted out WIN mothers into two archetypal life styles, "modernizers" and "traditionalists," whose perceived need for day care and preference for work outside the home are vastly different. See Samuel Z. Klausner, *The Work Incentive Program: Making Adults Economically Independent*, prepared for the U.S. Department of Labor, Manpower Administration (Philadelphia, Pa., 1972). This distinction may apply to other women also.

²³ State of Vermont Family Assistance Planning Unit and Mathematica, Inc., "Planning Papers," *State of Vermont Family Assistance Plan, V* (Princeton, N.J., 1972), p. 93.

Vermont's State FAP would have corresponded quite closely to the H.R. 1 program. However, the respondents do not correspond at all to a national sample, given the strong local traditions in the State, the absence of large urban areas, and the small number of blacks.

In addition, the sample suffers because FAP recipients who initially would have been required to work (those with children over 6) were mixed up with those who might have volunteered to work (with children under 6), and also with those earning just over the FAP-income cutoff who accounted for most of the households surveyed.

Another survey, the first in a longitudinal series, was carried out for a national sample of potential recipients of benefits under the first FAP proposal, which for our purposes corresponds quite closely to eligibility for FAP as proposed in H.R. 1. The survey of "poor" (that is, FAP-eligible), unemployed, nonmarried mothers (single, widowed, divorced or separated) revealed that 64 percent of the black women and 68 percent of the white women would need "child care arrangements to go to work." At the same time, 81 percent of the black women and 88 percent of the white indicated that they intended to seek work in the next 12 months.²⁴ Of the total black survey population, 5 percent of the unemployed poor (and 6 percent of the non-married poor) said they would accept a hypothetical job offer "if child care was satisfactory"; the responses for whites were similar.²⁵

The apparent disparity of responses (64 percent "need child care arrangements to go to work," but 6 percent would accept a job "if child care was satisfactory") in the same survey population is an indication of the unreliability of using the response rates to define the day care needs of the group. It also shows the difficulty of using opinion-poll type surveys which attempt to predict future behavior.²⁶

Studies of day care needs of AFDC mothers show that (according to recipients or their social workers) 27.6 percent of welfare mothers were not referred to manpower agencies for jobseeking or training because they are "required in home because of the age or number of children" and another 3.7 percent do not have "adequate child care arrangements." The combined total comes to nearly one-third of the mothers on AFDC.²⁷ As long as the welfare recipient and her social

²⁴ The questions were asked of the same respondents. Jack A. Meyer and John R. Shea, *Potential Recipients of Family Assistance Payments: Characteristics and Labor Market Behavior* (Columbus, Ohio, 1972), p. 215f.

On the other hand, 52 percent of the black mothers, and 46 percent of the white had worked for 6 months or longer in less than 10 percent of the years since they had left school, and 74 percent of the blacks and 71 percent of the whites had worked for 6 months or longer in fewer than 5 years since they had left school.

This sample is divided carefully as to respondent's race, which is necessary because of the higher labor force participation by blacks in the United States, and because the sample was overrepresentative of blacks. The ongoing population surveys are continuing and the study will eventually have four to six interviews per respondent over 8 years to draw on, in a sample divided by age and sex according to the census, and by race, poverty status and labor market experience according to survey data.

Despite these long-term goals, which will provide valuable material for many areas of the social sciences, the cited study is strictly cross-sectional, and not longitudinal.

²⁵ *Ibid.*, p. 82.

²⁶ Political polls, like the Gallup poll, correct for this by asking respondents questions like whether they are registered, whether they know where their polling place is, whether they voted in the last election. Asking questions about previous job history may serve a similar purpose in these polls, but often is not done, and in any case is a less useful correlation with future behavior because peoples' family situations change so drastically.

²⁷ U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, National Center for Social Statistics, *Assessments Completed and Referrals to Manpower Agencies by Welfare Agencies Under Work Incentive Program or AFDC Recipients* (Washington, D.C., 1972), table 5. See also Lawrence Podell, *Families on Welfare in New York City*, Center for the Study of Urban Problems, City University of New York (New York, N.Y., n.d.).

It has been argued that some of the mothers citing day-care need in fact do use informal arrangements currently, although they are unwilling to report them since they are used in order to earn income unreported to welfare authorities.

worker are convinced she is needed at home (under current WIN rules in the case of families with children under 6), she is excused from the work and training requirement but may volunteer. Thus, even if there are other barriers to her employment, she is not obliged to cite them. Therefore, the responses indicating that one-third of the welfare population need child care are of dubious value, since other job barriers are often present but unreported. The provision of day care facilities may be a necessary condition for these women to go to work (which is arguable), but it is not a sufficient condition. Day care problems may not be the most important reason for not working.²⁸

It simply cannot be assumed that there are no other barriers to keep these women from getting jobs should day care be provided them. The unemployment rate is not very encouraging; the female unemployment rate is less so; and the black female rate and the rate for women under 25 is disastrous. Thus, even if all respondents of these polls were to seek jobs and day care were provided, they would not necessarily find jobs, especially jobs which paid enough to cover day care costs or which were otherwise desirable to the women. Benefit loss rates reduce the value of a job to welfare recipients anyway. For example, in New Jersey a welfare mother of three who found a job paying \$900-\$1,000 per month would have a net gain, after taxes, reductions in welfare benefits, and payment of work expenses, of only about \$200 per month.²⁹ Among the welfare population, there may be psychological, health, and other difficulties which keep recipients from seeking work, as well as their frequent lack of education, experience, or marketable skills which reduce their attractiveness to employers. It can be argued that most respondents in the cited studies, including Westinghouse-Westat, would not or could not work even if they were provided with day care.³⁰ Furthermore, even those who worked might not use subsidized day care because of preference for other free arrangements, as will be seen later.

For the population generally, an increase in net wage resulting from subsidized child care would lead women to work fewer hours than they would without subsidized care.³¹ For families whose income is boosted

²⁸ This argument was well presented in Harold Feldman and Margaret Feldman, *A Study of the Effects on the Family Due to Employment of the Welfare Mother*, I (Ithaca, N.Y., 1972), pp. iv-v. The survey population was too narrow to provide indications of need, but the study contains some perceptive indications of problems with existing day care which often can be corrected by legislation, to be discussed later.

²⁹ Robert I. Lerman, "Incentive Effects in Public Income Transfer Programs," in *Income Transfer Programs: How They Tax the Poor*. Paper No. 4, prepared for the Subcommittee on Fiscal Policy, Joint Economic Committee. U.S. Government Printing Office, Washington, D.C., Dec. 22, 1972.

³⁰ One study concludes that only half the mothers in the Westinghouse survey population (under \$8,000 income) would find work. For the welfare or working poor families which the other polls use as samples, the employment rate would probably be lower. See Day Care Policy Study Group, *Alternative Federal Day Care Strategies for the 1970's*, submitted to Office of Economic Opportunity by Institute for Interdisciplinary Studies (Minneapolis, Minn., 1971-72), *Final Report: Part I* (1972), p. 50.

³¹ Based on a simulation using the March 1967, Current Population Survey data, from which a file was constructed of women living in the 97 largest standard metropolitan statistical areas. *Ibid.*, *Final Report: Part II* (1971), vol. 1, p. 194.

This analysis is of the behavior of women already employed, a group which may not correspond to women not now working. Ultimately only this sort of analysis can be taken seriously, given the limitations of opinion poll data.

by the provision of subsidized day care, the normal response would be to adjust to higher incomes by the woman working less. For the welfare population, on the other hand, it is difficult to prove that labor force participation would either rise or fall, since it is difficult to establish that this group would treat subsidized day care as a wage subsidy at all, given the following observation:

Since studies show that the amount paid for private day care decreases as income decreases, the AFDC population probably pays the smallest amount for private day care of any group—most probably, they pay nothing at all. Thus it is unlikely that this population would consider a subsidized day care program to be a “wage subsidy.” Therefore it is just as unlikely that they would respond by increasing their labor force participation.³²

Moreover, welfare recipients are not typically employable at high wages. Many would still be eligible for welfare supplementation. Thus, one study estimates that the provision of preschool day care to welfare recipients would reduce their number by only 2.5 percent, and the number of working poor families (eligible under H.R. 1) would be reduced by approximately 8 percent.³³ To repeat, subsidized day care is probably not a sufficient condition for these women to go to work.

Unfortunately, the legislative discussion of Government programs has attempted to assess the need for *day care in centers* by relating existing center places to “unmet needs” or by defining the programs the Government is supposed to subsidize exclusively to formal institutions called centers. However, middle class and professional women, who presumably can afford the kind of fees proprietary centers offering enriched programs charge, nonetheless often seem to prefer family day care arrangements.³⁴

Their preference for family-type arrangements (in their home or another person's) appears to be shared by the less affluent segments of the population. The Vermont survey found that 51 percent of the sampled low-income mothers working outside their homes either did not use available center day care or stated that they would not use such facilities if they were made available. Their reasons are given in the table which follows (table 1). Something like 75 percent of the

³² *Ibid.*, p. 202.

³³ Day Care Policy Study Group, *Alternative Day Care Strategies*, pt. I, p. 50.

³⁴ Mary Dublin Keyserling, *Windows on Day Care, A Report Based on Findings of the National Council of Jewish Women* (New York, 1972), pp. 49, 152, 184. Theoretical discussion of what we know about day care often unfairly neglects the Keyserling study as being too “anecdotal.” While the survey was not carried out by professionals, but rather by volunteers from the National Council of Jewish Women, and while it made no attempts to set up a representative sample, the very large number of day care situations which were viewed and judged in it makes it part of the material with which we must be concerned. The statistical tables included are probably of only marginal validity, particularly in the case of judgments on the quality of care, and less so in the case of fee data. The conclusions reached about the need for a massive Federal developmental program may be untenable. The arguments in favor of greater licensing and respect for licensed status are undermined by the data themselves. But nonetheless, this study tells us a great deal about what is happening in the real world. It provides the best data we have on truly bad situations which ought not to be ignored; it also provides some heart-warming stories about how, even in the absence of licensing, proper quarters, decent equipment and above all money, a warm-hearted care-giver without education, curricula, or even an idea of what the child-staff ratio is can give children good day care. See p. 128.

respondents did not or would not use day care centers because they are satisfied with their current arrangements.³⁵

TABLE 1.—*Reasons why child care center facilities are not utilized by low-income women in Vermont or would not be utilized if available*

[Percent]

Reasons for nonutilization	Respondents not using available day care	Respondents reporting they would not use day care if available	Total— both groups
Satisfied with current arrangements----	¹ 89	¹ 72	¹ 75
Costs too much-----	16	10	11
Overcrowded-----	2	2	2
Better care elsewhere-----	9	8	9
Too far away-----	16	4	6
Children ineligible-----	11	14	14
Don't like children there-----	3	4	3
Prefer caring for own children-----	12	18	17
Not open at right time-----	6	5	5
Children wouldn't like it-----	7	16	14
Own children too old-----	1	1	1
Care too impersonal-----	3		
Don't know-----		5	4
Total number of respondents----	466	2, 424	2, 890

¹ Multiple responses were permitted.

Source: Vermont-Mathematica, Vermont family assistance plan, p. 87.

There are other indications that many working mothers and currently nonworking mothers find day care centers unattractive. A certain amount of the difficulty may be related to factors of cost and distance, which will be discussed in other sections of this paper. But, part of the problem may simply be that many people do not like such institutions for their children. Moreover, child care given in their own home can be combined with light housework on the part of the caregiver, thus saving the working mother time and energy.

Testing the Vermont results against data from other parts of the country, the same sort of preferences appears to apply elsewhere. In upstate New York a poll of former welfare mothers (some of whom were working and some not) were asked, "if you could have any child care arrangement, where would you prefer to have it?" Only 17 percent preferred a regular day care center. This compares with 10 percent who actually used centers. On the other hand, 67 percent of respondents preferred care in their own homes and 11 percent in another person's home.³⁶

³⁵ Vermont-Mathematica, *Vermont Family Assistance Plan*, p. 87. Children who do not receive care apart from their presence in school were excluded. The similarity of responses of respondents *not using* and *not willing to use* center day care offsets to some extent our objection to opinion poll data. The main differences in reasons given by the two groups of working mothers were in attitudes toward distances and costs, obviously of greater importance to parents who are not sending their children to an existing facility rather than to a hypothetical one. Of course, this survey has the weakness of pitting bird-in-hand against birds-in-bush.

³⁶ Feldman and Feldman, *Effects on the Family*, I, p. 240.

Another indication that centers may not have widespread popularity is found in the results of the Gary, Indiana, income maintenance experiment. Only one out of 90 eligible parents accepted totally subsidized (free) day care for their preschoolers, despite the fact that two letters were sent, one telling them of the service, and the second stressing that it was free.³⁷

A recent study of the child care arrangements made by mothers in training programs highlights the importance of informal and often nonmonetary arrangements for children under 6. Respondents were enrolled in work training under three Government programs and one program, JOBS (Job Opportunities in the Business Sector), run jointly under Government and private-sector auspices. One of the Government programs, WIN (Work Incentive) was open to welfare recipients only, and provided day care subsidies of up to 100 percent of the cost of care in almost every State. The other two Government programs, MDTA (Manpower Development and Training) and CEP (Concentrated Employment Program), provided limited day care services or funds, while half the contracting employers under JOBS helped provide temporary child care arrangements (although none were reimbursed).

The main difference between these respondents and those in the Westinghouse-Westat sample of families with incomes below \$8,000 appears to have been an even greater choice of care in the mothers' homes, possibly due to a lack of information and available centers. Because poverty households are particularly subject to theft, the mothers may have wanted their homes looked after as well as their children. The other striking fact about the arrangements made is the small effect social service assistance had in arranging and *financing* day care for some respondents. WIN trainees in all but one State theoretically were eligible for subsidized day care, and for fully subsidized day care in half the States; nonetheless they used centers only slightly more often than other program trainees. Disadvantaged or welfare-recipient trainees, like the population generally, use informal arrangements in their own homes or the homes of others (friends, babysitters, relatives) rather than day care centers, even if the latter are free and available. They do not leave their children to look after themselves (none under 6 were without supervision in the sample population).³⁸

³⁷ Urban Institute, unpublished data. A study is being made of the causes of this nonutilization.

³⁸ Camil Associates, *Evaluation of Supportive Services Provided for Participants of Manpower Programs*, prepared for U.S. Department of Labor, Manpower Administration (Philadelphia, Pa., 1972), p. 64.

TABLE 2.—*Child care arrangements—First 3 children of trainees*

[In percent]

Child care arrangements	Training program mother enrolled in—				Total excluding JOBS
	CEP	MDTA	WIN	JOBS	
<i>Cared for self</i> -----	8	4	3	8	4
<i>School</i> -----	15	16	12	4	13
<i>In home:</i>					
Relative/ friend-----	30	26	25	48	26
Babysitter-----	6	12	15	8	13
<i>Out of home:</i>					
Relative/ friend-----	13	20	17	20	17
Babysitter-----	12	22	15	8	15
<i>Day care center</i> -----	15	11	14	4	14

Note: Only youngest child can be assumed to be under 6.

Source: Camil Associates, *Evaluation of Supportive Services Provided for Participants of Manpower Programs*, p. 64.

Cost problems have hitherto been excluded rather carefully from the discussion. In the studies in Indiana, Vermont, and upstate New York, an attempt was made to leave out the cost factor, since day care was to be free. In the WIN program, when free day care was theoretically available, the women did not behave very differently than when there were no subsidies as in the case of disadvantaged persons receiving job training under other programs.

Costs obviously do play a big role in parental preference for in-home care, however. The Massachusetts Early Education Project reported that 75 to 90 percent of all parents might be expected to use free, nearby, or in-home child care of the "right" kind, at hours corresponding to their work day. Conversely, fewer than 1 percent of all parents say they would use well-staffed child care for which they must pay full costs.³⁹ But the validity of such surveys is questionable. The additional factors of hours and location will be discussed elsewhere.

Another indication that demand for center care is not high is the size of waiting lists. Center waiting lists include 124,000 children, which amounts to about 16 percent of total day care enrollment in the institutions studied. The figure was very much higher for licensed nonproprietary (nonprofit) centers, where the waiting lists amounted to 45 percent of the enrollment. Some children may be on more than one list. On the other hand, there are some 63,000 unfilled day care slots, half in nonproprietary centers.⁴⁰ Another study found that 47 percent of nonprofit centers had openings and 73 percent had waiting lists.⁴¹ For profitmaking centers, 54 percent had openings and 40 percent had waiting lists. The average number of openings in day care homes considered by the volunteers who did the polling for the survey to be of poor quality was 6.3, for those considered fair was 4,

³⁹ Richard R. Rowe, et al., "Summary," *Child Care in Massachusetts: the Public Responsibility* (Cambridge, Mass., 1972), p. 8.

⁴⁰ Westinghouse, *Summary Report and Basic Analysis*, p. 25. Nonprofit centers probably charge less and, therefore, would have longer waiting lists. Some children might be on several waiting lists, of course.

⁴¹ Centers may have openings and waiting lists at the same time.

for those considered good was 3, and for those considered superior was 2.6.⁴² If proof were needed, parents can judge the quality of care quite well (or at least their judgments correspond with those of the volunteers doing the study) and tend not to send their children into poor day care.

A final point in discussing demand is that it would be difficult and inequitable to provide day care facilities financed by the taxpayer only to children whose mothers had just entered the job market. Thus, while we object to opinion polls indicating a huge need for day care subsidies or a need for day care slots by overstating the demand for new heavily subsidized slots, the polls understate the subsidies required to pay for families which currently make their own arrangements. Any new program would have to provide slots for children whose mothers already do work, although probably in smaller proportion than for children whose mothers do not now work since the working women would have more reason to remain with current arrangements than would new job entrants.

In summary, while there is some unmet demand for center care, the bulk of day care in this country is now being provided in homes. Examining the evidence, we can state that data about vacancies and waiting lists for center care are inconclusive, and that estimates of the number of nonworking mothers of preschool children in need of day care to work (as estimated by themselves) appear to be highly contradictory and at variance with studies of how these mothers do in fact behave when day care becomes available. Of course, it is entirely possible that if free or heavily subsidized day care centers of good quality (and, therefore, quite expensive) were universally available, demand would rise to equal the supply. But this is a different question from how urgent the current need is for a large-scale, Government-subsidized day care center program, and has little bearing on how desirable such a program would be—both in itself and in relation to other pressing social needs.

BUDGETS, FEES AND WHAT PARENTS PAY: THE COSTS OF DAY CARE

Up and down the City Road
In and out the Eagle,
That's the way the money goes,
Pop goes the weasel.
A farthingsworth of tuppenny rice,
Half a cup of treacle,
That's the way the money goes,
Pop goes the weasel.

How Much Does Day Care Cost? How Much Is Government-Supported Day Care Costing Now? How Much Would an Expanded Program Cost? How Much Do Parents Pay for Day Care Now?

The discussion of day care costs is complicated by a surplus of data sets which often are not strictly comparable, even if it is assumed that the day care being discussed is being given for the same number of hours to children of the same age (which in fact is not always the case).

⁴² No such breakdown was available regarding centers. Two-thirds of the homes reported that they had openings. Keyserling, *Windows on Day Care*, pp. 93, 145, 146.

It takes little statistical or accounting skill to budget a form of day care, given a specification of the care to be offered. The most important cost factor is the child-staff ratio. Other important factors are the education or experience to be required of the staff and their corresponding level of pay, whether or not meals and trips are provided without extra charge, whether health, social work, or psychological services are being provided, whether education in art or music is being provided by specialists, and whether money is being provided for training or to allow for training of care-givers, their supervision, and administration. It is bad accounting to omit "overhead" costs, but costs are not always imputed for rent, utilities, telephone, janitorial or administrative services, or even consumable equipment, and in fact are often not calculated properly by center operators or mothers providing day care. Finally, provision of transportation to and from the day care situation usually is not calculated as a cost, although parents generally must pay for it.

The most frequently cited estimates of the unit costs of day care were made in 1967 by Jule Surgarman and Lawrence Feldman. Center care for pre-school children was expected to cost \$1,245 annually per child for a minimum program, \$1,862 for an acceptable program, and \$2,320 for a desirable program.⁴³ Family day care at a minimum level was expected to cost \$1,423, at an acceptable level \$2,032, and at a desirable level \$2,372.⁴⁴

The 1968 Federal day care requirements officially apply to all day care subsidized by the Federal Government, including that provided to welfare mothers enrolling for work or training. In fact, there is no enforcement whatsoever unless the State or municipality chooses to apply the standards. Few do. In addition, the 1968 requirements have been relaxed in areas significant enough to have aroused clamor from child welfare specialists. The 1972 Federal day care standards, which at this writing have not been officially promulgated by HEW, have been costed by Donald G. Ogilvie of the Inner City Fund. On the basis of his data, we have calculated that the mean annual costs of center day care per child (in the 31 largest U.S. cities) dictated by the 1972 standards amount to a substantial \$1,554 for children aged 3 to 4½ years and \$1,311 for children aged 4½ to 6.⁴⁵

⁴³ U.S. Department of Health, Education, and Welfare, Children's Bureau, and Day Care and Child Development Council of America, "Standards and Costs for Day Care" (Washington, D.C., 1968, unpublished) as given in Mary P. Rowe, "The Economics of Child Care," in *Child Care*, hearings before the Senate Committee on Finance, 92d Cong., 1st sess. (1971), p. 280.

⁴⁴ Ibid.

⁴⁵ Ogilvie, *Estimated Costs*, p. 16. Note that while we have derived means for 30 cities on the basis of Ogilvie's cost index, all breakdowns of costs are based on the detailed cost analysis for Washington, D.C., as given by Ogilvie.

TABLE 3.—Comparison of 1968 and 1972 HEW standards and annual costs per pre-school child for full day care, 5 days per week to preschoolers

Cost component	Day care center, 1968			Family home, 1968			Day care center, 1972		Family home, 1972	
	Minimum	Acceptable	Desirable	Minimum	Acceptable	Desirable	Ages 3-4½	Ages 4½-6	Ages 3-4½	Ages 4½-6
Food, meals, and snacks.....	¹ \$140	² \$210	² \$210	¹ \$100	² \$150	² \$150	³ \$175	³ \$175	³ \$175	³ \$175
Transportation.....	(⁴)	⁵ 60	⁵ 60	(⁴)	(⁴)	(⁴)	(⁴)	(⁴)	(⁴)	(⁴)
Medical and dental services.....	⁶ 20	⁶ 20	⁶ 20	⁶ 20	⁶ 20	⁶ 20	(⁴)	(⁴)	(⁴)	(⁴)
Work with parents.....	⁹ 10	¹⁰ 30	¹¹ 70	⁹ 10	¹⁰ 30	¹¹ 70				
Facilities and utilities.....	¹² 90	¹² 90	¹² 110	¹² 30	¹² 30	¹² 30			(¹⁴)	(¹⁴)
Clothing and other emergency needs.....	¹⁵ 20	¹⁵ 20	¹⁵ 20	¹⁵ 20	¹⁵ 20	¹⁵ 20	¹⁵ 90	¹⁵ 90	(¹⁴)	(¹⁴)
Supplies and materials.....	¹⁷ 40	¹⁷ 50	¹⁷ 75	¹⁷ 20	¹⁷ 35	¹⁷ 50	(¹⁴)	(¹⁴)	(¹⁴)	(¹⁴)
Equipment.....	¹⁷ 10	¹⁷ 12	¹⁷ 15	¹⁷ 9	¹⁷ 15	¹⁷ 20	¹⁷ 40	¹⁷ 40	(¹⁴)	(¹⁴)
Staff:							¹⁷ 6	¹⁷ 6	(¹⁴)	(¹⁴)
(a) Classroom professional.....	²⁰ 275	²⁰ 405	²⁰ 405				²¹ 536	²¹ 409		
(b) Classroom nonprofessional day care mother.....	²² 320	²² 420	²² 420	²³ 880	²⁶ 1,100	²⁶ 1,100	²⁷ 402	²⁷ 246	²⁷ 1,230	²⁷ 820
(c) Social service professional.....	²⁹ 65	²⁹ 65	²⁹ 65	²⁸ 44	²⁹ 66	²⁹ 66	(¹⁴)	(¹⁴)	(¹⁴)	(¹⁴)
(d) Community, social service parent or health aides.....	³⁰ 0	³¹ 20	³⁰ 45	³⁰ 44	³⁰ 44	³⁰ 44	(¹⁴)	(¹⁴)	(¹⁴)	(¹⁴)
(e) Business and maintenance.....	³² 80	³² 120	³² 120	³² 80	³² 80	³² 80	³⁴ 58	³⁴ 58	(¹⁴)	(¹⁴)
(f) Special resource personnel (psychology, music, art, consultants).....	³⁵ 20	³⁵ 60	³⁷ 120	³⁵ 20	³⁶ 132	⁴⁴ 264	(¹⁴)	(¹⁴)	(¹⁴)	(¹⁴)
(g) Supervision/administration.....	³⁸ 80	³⁸ 160	³⁸ 160	³⁸ 80	³⁹ 160	⁴⁰ 240	⁴¹ 338	⁴¹ 338	(¹⁴)	(¹⁴)
Training.....	⁴² 75	⁴² 120	⁴² 145	⁴² 110	⁴² 150	⁴² 178	(¹⁴)	(¹⁴)	(¹⁴)	(¹⁴)
Other items (including transportation).....							⁴⁷ 57	⁴⁷ 75	⁵⁰ 50	⁴⁹ 49
Commercial rentals (additional).....							(¹⁰³)	(¹⁰⁸)		
Costs per child year.....	1,245	1,862	2,320	1,423	2,032	2,372	1,702 ⁴³	1,438 ⁴³	1,455	1,044
							1,811	1,546		

¹ 1 meal and 2 snacks.

² 2 meals and 2 snacks.

³ 1 meal and 2 snacks.

⁴ Provided by parents.

⁵ Bus trips and excursions included.

⁶ Examinations and referral.

⁷ Treatment when not otherwise available.

⁸ At \$6,500 per year, 1 per 15 children.

⁹ Little or none except on problem cases.

¹⁰ General parent activities plus limited counseling service.

¹¹ Parent education, family-type activities, full counseling services.

¹² Space meeting State and local licensing requirements.

¹³ "More generous room for child activities plus room for work with parents."

¹⁴ Not included.

¹⁵ Utilities plus residential rental.

¹⁶ As necessary.

¹⁷ Custodial or limited developmental program.

¹⁸ General developmental program.

¹⁹ Individualized or enriched developmental program.

²⁰ At \$6,500 per year, 1 per 20 children.

²¹ At \$7,800 per year.

²² At \$4,400 per year, 2 per 20 children.

²³ At \$4,400 per year, 2 per 15 children.

²⁴ At \$4,400 per year, 3 per 15 children.

²⁵ At \$4,400 per year, 1 per 5 children.

²⁶ At \$4,400 per year, 1 per 4 children.

²⁷ At \$4,680 per year.

²⁸ At \$6,600 per year, 1 per 150 children.

²⁹ At \$6,600 per year, 1 per 100 children.

³⁰ At \$4,400 per year, 2 per 100 children.

³¹ At \$4,400 per year, 1 per 100 children.

³² At \$4,000 per year, 2 per 100 children.

³³ At \$1,000 per year, 3 per 100 children.

³⁴ Half-time janitor at \$1.50 per square foot plus supplies.

³⁵ Urgent need only.

³⁶ At \$6,600 per year, 1 per 100 children.

³⁷ At \$6,600 per year, 2 per 100 children.

³⁸ At \$8,000 per year, 1 per 100 children.

³⁹ At \$8,000 per year, 2 per 100 children.

⁴⁰ At \$8,000 per year, 3 per 100 children.

⁴¹ Director at \$9,000 per year; secretary at \$5,000 per 36 children.

⁴² Set at 10 percent of annual salary costs.

⁴³ Costs in commercially rented, nonresidential facility.

⁴⁴ At \$6,600 per year, 4 per 100 children.

Sources: Mary Rowe, "Standards and Costs," Child Care Data and Materials, Senate Finance Committee, 92d Cong., 1st sess. (Washington, D.C., 1971), p. 132 ff., and Ogilvie, "Estimated Costs of the Federal Day Care Requirements," *passim*.

TABLE 4.—*Costs of center day care in 31 cities (per child per year, by age of children)*

City	Age of children	
	3-4½	4½-6
New York.....	\$1, 838	\$1, 539
Chicago.....	1, 838	1, 539
Washington, D.C.....	1, 702	1, 438
Philadelphia.....	1, 702	1, 424
Detroit.....	1, 634	1, 380
Milwaukee.....	1, 634	1, 366
San Francisco.....	1, 617	1, 366
Pittsburgh.....	1, 617	1, 352
Buffalo.....	1, 583	1, 337
Los Angeles.....	1, 583	1, 337
Cleveland.....	1, 566	1, 337
Baltimore.....	1, 583	1, 337
Boston.....	1, 566	1, 323
Green Bay.....	1, 532	1, 294
San Diego.....	1, 549	1, 309
Seattle.....	1, 549	1, 309
Minneapolis.....	1, 515	1, 265
Dayton.....	1, 532	1, 309
Atlanta.....	1, 481	1, 251
Indianapolis.....	1, 499	1, 280
Cincinnati.....	1, 505	1, 265
Baton Rouge.....	1, 464	1, 237
St. Louis.....	1, 481	1, 237
Houston.....	1, 481	1, 251
Denver.....	1, 447	1, 222
Nashville.....	1, 447	1, 222
Orlando.....	1, 464	1, 237
Portland, Maine.....	1, 464	1, 237
Kansas City.....	1, 430	1, 208
Dallas.....	1, 447	1, 237
Wichita.....	1, 413	1, 194
Mean.....	1, 554	1, 311

Source: Ogilvie *Estimated Costs of the Federal Day Care Requirements*, p. 16. Costs by city based on indexes from Inner City Fund model, with mean derived by author.

TABLE 5.—*Regional costs of center day care (per child per year, by age of children)*

Area	Age of children—	
	3-4½	4½-6
Northeast:		
Urban.....	\$1, 736	\$1, 467
Rural.....	1, 498	1, 237
North Central:		
Urban.....	1, 634	1, 366
Rural.....	1, 447	1, 237
South:		
Urban.....	1, 515	1, 237
Rural.....	1, 345	1, 136
West:		
Urban.....	1, 532	1, 309
Rural.....	1, 396	1, 179

Source: Ogilvie, *Estimated Costs of the Federal Day Care Requirements*, p. 14, derived by author from index data.

Any attempt to predict the costs of a future Federal day care program on the basis of these numbers is unrealistic because these numbers bear little or no relation to how much existing Government programs cost per child, or how much parents currently spend.

Statistics on how much parents are spending on day care are difficult to find, given the prevalence of informal arrangements which are extremely difficult to control for and are rarely priced to cover the full costs of the care. But the cost of prekindergarten (under 5) education—by which is meant a school-year program averaging 36 weeks per year and 36 hours per week—is rather well documented. It should be realized at once that per pupil expenditure may not be wholly accurate, however, since building and maintenance expenditures generally are not included. The mean prekindergarten expenditure per pupil for the day care age group (roughly ages 3 to 5) in 1968-69 was:⁴⁶

In cities.....	\$716
In suburbs.....	1, 015
In independent school districts.....	1, 063

Using the figure for city prekindergarten expenditures as perhaps the most realistic in defining a minimal program, and using the Bureau of Labor Statistics day-care education index to bring the figure up to date (October 1972), nursery school cost per pupil would be \$830 at present. This figure corresponds closely to Head Start expenditures and to the fees currently being charged in the District of Columbia by private nursery schools. Calculating the fees on the basis of a 52-week year and a 9-hour day yields a day care cost per pupil of \$1,798, which is well within the range of costs estimated for the 1972 guidelines. If correction is made for the costs of building and maintenance, for the higher suburban spending per pupil, and for food service, costs will be higher than the HEW calculations.⁴⁷

The disparities between the costs calculated in 1967 and 1972 are even greater if we recall the effects of inflation in this period. The explanation lies in qualitative differences in the care specified in the two years. Unlike the 1968 standards, the 1972 standards provide no funds for the following items:

	1968 cost estimate
Transportation (trips) (per year per child).....	\$60
Medical and dental services.....	20-60
Work with parents.....	10-70
Clothing and other emergency items.....	20
Equipment.....	9-20
Social service professional.....	44-66
Community, social service or health aides.....	0-45
Special resource personnel.....	20-264
Training.....	75-178
Total "saved" in 1972 standards.....	\$258-783

⁴⁶ William P. McLure and Pince, Audra May. *Early Childhood and Basic Elementary and Secondary Education: Needs, Programs, Demands, Costs* (Urbana-Champaign, Ill., 1970), p. 74. The lower figure for cities can be presumed to reflect budgetary considerations.

⁴⁷ School systems in general do not provide free food to children. Either parents are charged or else the children bring sandwiches from home which their parents make. However, free school lunches are provided to children from low-income homes and to all children in schools in most poor neighborhoods.

Whether these services ought to have been omitted is a policy question, not a costing problem. It might be argued that many of these social services, even when provided through day care facilities, ought not to be charged to the account of day care. This is not the case for special resource personnel (music and art consultants, for which read "teachers") or for the training of day care personnel, which, if not funded by the day care budget, will not be provided at all.

These changes in the day care specifications explain why the cost of the 1972 standards offsets the effects of inflation on teacher and administrator pay. Facility and utilities costs were presumed to have remained constant for centers, and were not added in for day care homes at all. Food costs were adjusted upward for inflation after being adjusted downward by the elimination of a second daily meal.

Turning from theory to reality, the first point to note is that the fees being charged (and therefore the amounts parents are paying and to some extent, the amount the Government is paying) often do not cover the costs of day care. This may be because of employer or Government subsidies, because parents are providing the service themselves (sending box lunches or formula to the center or day care family with the child, or doing the transporting themselves), or paying for it separately (again most probably in the case of meals and transport, including trips and excursions), or because costs are being calculated improperly by the care-giver or the center in setting fees. Hence, it should not be surprising that the amounts now being paid for care vary even more than the amounts calculated for the cost of standard care.

In fee terms, the costs of day care start at nothing for totally subsidized children in some programs; for children looked after by a relative or a neighbor for nonmonetary gratification; for children looked after as part of another relation of the care-giver and the parent which may be based on payments, such as landlady, maid, or employer. The highest fees range up to more than \$3,000 yearly per child in places like the Sutton Place MultiMedia Preschool in New York City.

Costs to the Government for providing day care show a similar range. If a child of a working welfare mother or one in training is looked after in his own home in New York or Washington, a maximum of \$250 in total is paid per child per year to the care-giver⁴⁸ who is presumably but not necessarily a relative. In general, the children of trainees were looked after at an average cost of \$12-\$15 per week in centers (\$624-\$780 per child-year), and \$10-\$12 per week by private sitters (\$520-\$624 per child-year).⁴⁹ Costing the Government the most was the Office of Economic Opportunity Child Development Center in Washington, D.C., at \$3,300 per child per year.⁵⁰ Government expenditures per child under various programs are shown in table 6.

⁴⁸ Information given to author by Human Resources Department officials in these cities. The rate of pay is probably the same elsewhere too.

⁴⁹ Camil Associates, *Evaluation of Supportive Services*, p. 70f.

⁵⁰ Part of this outlay was reimbursed by fees but the program was seen as requiring a \$1,080 annual subsidy per parent under optimum conditions. See Westat, Inc., *Evaluation of OEO Child Development Center*, prepared for Office of Economic Opportunity (Rockville, Md., 1972), p. xiii.

TABLE 6.—*Per child expenditure under Federal day care programs (dollars per child per year)*

Program	1971 (actual)	1971 with State matching	1972 (actual)	1972 with State matching	1973 (estimate)	1973 with State matching	1974 (estimate)	1974 with State matching
WIN-----	\$276		\$203		\$389		\$437	
With State matching (10 percent)-----		\$329		\$226		\$432		\$486
Title IV-A ¹ -----	524		556		559		610	
With State matching (25 percent)-----		699		741		745		813
AFDC income disregard-----	160		164		172		179	
With State matching (40 percent)-----		267		273		287		298
Model Cities-----	429		480		483		467	
Headstart (full schoolday)-----	1, 222		1, 153		1, 187		1, 187	
AFDC nonwork-related-----	521		561		556		609	
With State matching (25 percent)-----		695		748		741		812
Average-----	390	496	417	536	466	591	486	626

¹ Title IV-A of the Social Security Act.Source: *Special Analyses: Budget of the U.S. Government: Fiscal Year 1974* (Washington, D.C., 1973). Data derived and corrected for matching requirements by the author.

In practice, Federal expenditures for day care in 1972 worked out to only \$417 per child. This may be because parents picked up part of the tab. However, given that most funds went to current, former, and potential welfare recipients (under title IV-A of the Social Security Act) and to disadvantaged children (Head Start), parental contributions were probably minimal. Some of these expenditures provided kindergarten children with care after school and in the summer, which may have pulled down the average spent per child. But no amount of juggling will bring the per-child total annual expenditure much over \$650.⁵¹

Per child expenditures for Head Start averaged \$1,153 in fiscal year 1972 and are expected to reach \$1,187 for fiscal year 1973. Head Start is fully funded by the Federal Government and provides quality developmental care to disadvantaged preschoolers. Nationwide, most Head Start programs do not fill the total day care needs of enrolled children whose mothers work, since they are often half-day or school-day (9 a.m. to 3 p.m.) programs. The per child expenditure varies enormously by State from a low (1972) of \$396 per disadvantaged preschooler in Wyoming to \$1,756 in New York.⁵²

Looking at the care provided for children of WIN mothers, whose plight is similar to that which would be confronted by recipients under a welfare reform program with a work requirement, the most important thing that can be said is that the HEW guidelines (in this case, the 1968 standards) seemed to make absolutely no difference in the day care they were given. In fact, since almost all welfare mothers enrolling in the work incentive program who have preschool children are volunteers who have opted for training to improve their job prospects, they are women who have indicated a strong desire to get off welfare. One would expect that the agencies dealing with them would be most sympathetic to their day care needs. In studies of WIN mothers it was learned that:

Not only did the overwhelming majority (88 percent) arrange their own plans, independent of welfare, but that most (80 percent) were informed by their caseworkers that it was their responsibility to do so * * * the majority of mothers (83 percent) who were informed about child care by their caseworkers were left with the impression that they could make use of any service they wanted; approved services were not required.⁵³

As one would expect, the result was that few children of WIN mothers were enrolled in day care centers (just under 17 percent).⁵⁴ WIN mothers deliberately may have opted to put their children in informal and unregulated care, at home, with relatives, in child-minders' homes, and so on, for good reasons (the same as led the Vermont or Gary mothers not to use free or subsidized center day care when it was offered). But in most cases it appears that social workers left them to their own devices, in violation of the rules of title IV, which

⁵¹ *Special Analyses: Budget of the United States Government; Fiscal Year 1974* (Washington, D.C.: Government Printing Office, 1973), p. 128. Data derived and corrected for matching by author.

⁵² Unpublished data from the U.S. Department of Health, Education, and Welfare, Office of Child Development.

⁵³ Auerback Corp., *An Appraisal of the Work Incentive Program*, submitted to the Department of Labor, Manpower Administration, Office of Evaluation Philadelphia, Pa., n.d.), p. 6-24f.

⁵⁴ U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, *Services to AFDC Families* (Washington, D.C.: Government Printing Office, 1971), p. 39. Camil Associates, *Evaluation of Supportive Services*, p. 65, gives a more recent estimate of 14 percent.

require that the Federal Interagency Family Care Standards (the HEW guidelines) be followed.

The amount which parents paying for their own child care spend also falls well below the 1968 and 1972 standards estimates. Nearly three out of four children whose mothers worked full time in 1965 received free care. For only 10 percent of the children did the care used cost over \$500 per year.⁵⁵ The Westinghouse-Westat survey found in its 1970 sampling of working mothers with family income under \$8,000 that 70 percent of the children received care, mostly in their homes, costing the mother under \$360 a year.⁵⁶ Day care arrangements costing the parents over \$650 per year were made for only 6 percent of the children. Of the parents not satisfied with the care their children were receiving, over 40 percent were willing to pay no more than \$350 per year, and another 36 percent would pay no more than \$650. Sixteen percent of the mothers were unwilling to pay anything for the desired change.⁵⁷

A final source of information on the costs of day care would be the fees charged by child-minders and centers. Use of this sort of information tends to be misleading. Fee schedules often are set up with an implicit subsidy to some or all children, even in the case of non-Government day care facilities. For example, a nonprofit, church-linked center in Washington, D.C. charges \$40 per week for the first child in a family to attend. The second and all subsequent children are charged \$20 per week. It was felt that this was the only way to attract middle-class families to use the center, and thus parents of only one child are subsidizing those who have several in the day-care age bracket.⁵⁸ Other forms of adjustments in fees, even in centers run for profit, are often used to adjust for parental income.⁵⁹

Apart from deliberate adjustments, there is often a failure to impute startup costs or to calculate properly the cost of rent, insurance, utilities, depreciation, and maintenance. In the case of centers set up in churches, in donated quarters, or in employer-donated sites, of course, it may not be proper to include certain overhead expenses. In the case of at-home care, day care mothers often fail to account for their own work (food preparation, tidying up), equipment (toys, sandpile, etc.), or their quarters (which are also used by the family). Equipment is often donated, as are used toys and books. But, in general, the fact that these costs are not calculated in setting fees does not mean they are not incurred.

This undercosting of some items was illustrated in a recent study of family day care mothers (styled FDCM's):

Our staff dealt with the matter of costs in a very careful manner. We had discussed costs in one Center meeting and became painfully aware of the variety

⁵⁵ Seth Low and P. G. Spindler, *Child Care Arrangements of Working Mothers in the United States*, prepared by U.S. Department of Health, Education, and Welfare, Children's Bureau and Department of Labor, Women's Bureau (Washington, D.C., 1968), p. 11.

⁵⁶ Westinghouse-Westat, *Day Care Survey*, p. 187.

⁵⁷ *Ibid.*, pp. 187, 164.

⁵⁸ The center in question, the St. Albans Day Care Center, also has wholly subsidized slots for poor children, paid for by donations.

⁵⁹ Keyserling, *Windows on Day Care*, p. 86. The Keyserling study found that publicly supported programs which set a flat fee set it higher than profitmaking centers. On the other hand, when a sliding scale was used, adjusting fees for income, the charges to parents under public day care programs, hospital programs, and philanthropic centers was substantially lower than in proprietary centers. This says very little about costs.

of services offered by one FDCM who never considered them as a cost item—after all, going on a trip was “just a family outing” (the cost of admission to a petting zoo, snacks purchased, plus the cost of gasoline, use of the car, the need for an extra car seat were all items she had never considered before.)

Discoveries such as this were painful for the staff. On the one hand, we were concerned that further inquiries might make that woman aware of extra expenses and that she might (1) charge the parents more, which they might not be able to afford, or (2) stop delivering a “developmental” service (trip to the zoo). On the other hand, we were appalled at the low pay received by the women, and our women’s-lib selves were angered at the exploitation by society of women whose services were beyond monetary calculation.⁶⁰

In finding out the costs of existing day care services (as opposed to theoretical budgeting) a type of Heisenberg principle applies: asking certain questions changes the answers.

Given all these problems, it is with some hesitation that the Keyserling findings regarding the average fee charged parents in centers run for profit are presented: \$18.10 per week per child (flat fee) or \$19.15 (sliding fee), or \$941–\$996 per year.⁶¹ Family-day-care average annual costs were \$858 (\$16.50 per week). The Westinghouse study found that costs for profitmaking centers were \$456 per year, although parents were charged \$576 (to allow for profit) and that nonprofit centers had costs and revenue at \$1,020 per child-year.⁶² The disparity between these numbers and those in HEW’s 1968 and 1972 standards appears to need explaining. Why are the estimated costs of meeting the Government standards so high?

The first reason is one already touched upon. The HEW estimates are based on fully costing “overhead” in day care centers. Overhead is not costed in the HEW estimates for family day care homes, which is a major reason why this form of day care comes out looking financially attractive. But in practice neither centers nor day care mothers appear to calculate these costs in a realistic fashion when setting fees.⁶³

Secondly, the HEW standards for care in the child’s own home or the care-giver’s home (the former regulated for the first time in the 1972 standards) stress the child-to-care-giver ratio, which is very difficult to control in the family context. Meeting the standards would push fees up substantially or reduce family home revenues since family day care mothers could care for a smaller number of children (their own or others) after school if the ratios were enforced than they generally do. In practice the child-to-care-giver ratio in a

⁶⁰ June Solnit Sale, et al., *Open the Door * * * See the People: A Descriptive Report of the Second Year of the Community Family Day Care Project*, prepared by Pacific Oaks College for the U.S. Department of Health, Education, and Welfare, Office of Child Development, Children’s Bureau (Pasadena, Calif., 1972), p. 69.

⁶¹ Keyserling, *Windows on Day Care*, p. 86. The author finds these data to be useful in correcting the findings of the Westinghouse study (because of sampling problems in the latter study’s discussion of family day care homes, comparison of the categories is difficult.) The Keyserling study focused almost exclusively on licensed homes (134 of 157), however.

⁶² *Ibid.*, p. 142.

⁶³ In the case of family day care mothers, some sort of sophistication might result from their making enough money (or being honest enough) to file for income tax allowances for using their home to run a business. In the income bracket in which most of them fall, it would appear that following IRS rules would allow them to recover a substantial portion of their overhead through tax deductions, of mortgage or rent, property taxes, utility bills, and so forth, as business expenses. Publicity might help these mothers exploit the helpful provisions of the tax code.

homelike situation of necessity varies with the schoolday and with what the pre-school child himself is doing at any given moment.

Thirdly, estimates of the costs of the 1972 standards presuppose that the care-giver, even a woman in her home looking after her own child and those she is paid to mind (no more than six children in all), is being paid the minimum wage. Citing Westinghouse survey data, however, William R. Prosser notes that family day-care mothers now get average payments of 60 cents an hour for looking after two or three children 45 hours per week.⁶⁴ From this money, many family day-care mothers provide meals, extra rent or utilities, telephone, carfare for trips or medical visits, cleaning up, and so forth.

Based on the above, it should not be assumed that the 1972 Federal standards which will shortly be promulgated are in some way over-generous. Rather, the 1972 standards have rolled back many social and educational programs and features of the 1968 standards. Instead of a 1 to 5 staff-to-child ratio, the draft 1972 standards set a ratio of fewer than 1 to 7 for children aged 3 to 4½, and fewer than 1 to 10 for children 4½ to 6. The change, naturally, is of some concern to specialists. Federal standards are unwieldy things. It is commendable that an attempt was made to differentiate requirements by children's ages. Even more unwieldy would be an attempt to follow the Danish practice of setting different ratios according to the child's activity.⁶⁵

Abandonment of some of the widest-reaching Federal requirements for day care (social services and free medical care) might be commended for eliminating extraneous expenditures. The same might hold for the child-to-staff ratio changes, which have been exaggerated.⁶⁶

But, in general, the HEW standards do not apply to the overwhelming bulk of the care arrangements for the pre-school children in the country as a whole, or even in practice to those children for whose care the Federal Government has official responsibility (those of welfare mothers in training, for example). Focus on the Federal standards and their reduced (but still high) per child annual costs may even be counterproductive, since it exaggerates the problem of meeting real needs, just as exaggeration of what those needs are is also counterproductive.

Perhaps part of the problem can be attributed to the great interest in the theory of day care and the lack of interest in the nuts and bolts of actually getting care to the working mother so that she can use it. The Federal Interagency Day Care Standards are a good illustration of this problem. They emphasize "developmental" issues to such a degree that they have proved costly and impractical for large scale adoption of day care for children of manpower trainees.⁶⁷

Federal standards theoretically apply to a minority of day care arrangements, and in practice they do not apply to even those paid for by Federal or federally matched money, as we have seen. Thus, changes in the standard from the ideal are nowhere as significant as

⁶⁴ Office of Economic Opportunity, Office of Planning, Research and Evaluation, *Day Care in the Seventies—Some Thoughts* (unpublished working paper), p. 6, based on Westinghouse data.

⁶⁵ Grotberg, *Day Care*, p. 10.

⁶⁶ The author's son, aged 54 months (4½ years) attends a Montessori kindergarten where the normal child to staff ratio is 10½ to 1. When the teacher or her aide is absent (about 10 percent of the time), it is 21 to 1. This is standard in Montessori schools, where the ages of the children in a class are mixed (2½ to 7 in some cases).

⁶⁷ Camil Associates, *Evaluation of Supportive Services*, p. 53.

some have charged. The standards are not very relevant in theory (as will be discussed below for two of the areas HEW no longer wants to regulate); they are even less relevant in the context of the current American day care economy, in which most children are not in centers and most welfare mothers going out to work do not use federally regulated day care; in which the great bulk of the working poor are not being provided with any day care by the Government; and in which the welfare bureaucracy operates without much concern for the Federal day care requirements. The significant fact about the HEW requirements is that they are unenforceable. In part it is because they are so expensive that few children are benefiting: there is a necessary tradeoff between a program's costs and its coverage.

In Alice Rivlin's words:

* * * a two-class system has evolved in day care, with a small proportion of the poor getting more comprehensive and costly care in subsidized day care centers than is available to the nonpoor in unsubsidized centers.⁶⁸

In conclusion, we can say that day care is expensive, and Government regulated day care even more so, but that Government regulation applies to only a minority of the children being served. Day care appears to cost the buyer marginally over \$1,000 per year per child in centers, and something between \$700 to \$1,100 in family day care homes. Many more children are looked after for free or noncash gratification. Fees charged do not take full account of real costs, and caregivers and society set a low value on their services (part of which may be made up for by noncash gratification).

DEVELOPMENTAL CARE—COST OR BENEFIT?

One, two, buckle my shoe.
Three, four, shut the door.
Five, six, pick up sticks.
Seven, eight, lay them straight.

* * * * *

Nineteen, twenty,
My plate's empty.

Is there something called developmental care? Is it best provided by day care centers?

The emphasis on developmental day care results from several misconceptions. The most common arises from the definitions of the 1968 HEW standards (prepared, in fact, by the Day Care and Child Development Council of America, an advocacy group or lobby), which differentiated between developmental, acceptable, and minimum day care in terms that are easily measured, like the child-staff ratio and the level of staff training. While these standards have now been abandoned by HEW, they were retained (at a lower level) in H.R. 1, and the philosophy that ratios have something crucial to do with development lives on. Developmental care may or may not be provided to the children at various child-staff ratios, but the guidelines do not assure that it is or is not provided.

Developmental care defined by staff ratios is often justified by the Head Start practice. It now appears that the educational advantages Head Start gives its graduates do not remain with them once

⁶⁸ Alice M. Rivlin, "Child Care," in Charles L. Schultze, et al., *Setting National Priorities: The 1978 Budget* (Washington, D.C., 1972), p. 262f.

they have entered the school system. The "failure of Head Start" in producing durable gains turns out to be true of gains in cognitive development or IQ made by "graduates," including middle-class children, of other preschool programs such as half-day nursery school.⁶⁹ Using Head Start as an example also ignores the fact that almost no Head Start programs provide full, working-day care to the enrolled children. For example, in New York:

Head Start has been a half-day program (3-3½ hours) until recently when some were converted to full day operation. Half-day Head Start programs typically have two shifts of children between the hours of 8:30 a.m. and 4:30 p.m.; full day programs serve children from 9 a.m. to 3:30 p.m.⁷⁰

Even "full day" Head Start does not meet the needs of the children whose mothers work full time. In Washington, D.C., where Head Start programs usually operate for 3 to 6 hours per day, 80 percent of the children's mothers work for at least 7 hours per day.⁷¹

There appears to be a tradeoff between educational goals and day care goals, at least in program design. But, given that many parents do some educating of their children, it is clear that day care arrangements must do at least that much educating, too. Otherwise, a day care program could not be justified for any children except those whose parents completely neglected them.

On the other hand, there are real limits to how much education can be given to pre-school children (who almost by definition are too young to be schooled). There are also problems in defining education once we realize that book learning, preparing to read, learning the alphabet or numbers, and so on, are either impossible with the day care age group, or involve only a marginal part of their day care life. Almost no book learning is going on in day care centers to justify the "developmental" label that is not happening in family care, or that could not happen in family care with a bit more cash and understanding. By extension, staff education credentials are less meaningful the day care context than they have been made to appear.

An average 3-year-old can hardly be taught anything for more than 2 hours a day because he is too restless and has too short an attention span. A 4-year-old can manage a bit more "enrichment." And 5-year-olds, as school systems have known for decades, can manage a half day of school but not much more. In caring for these children, much time necessarily is spent in activities that bear no intellectual content: 2 hours of naps per day on average and at least another 2 hours in eating a meal and two snacks. It takes at least a half hour to get children dressed and undressed each day. They will spend at least an hour outdoors if the weather permits, or, if they must remain indoors, they will probably play some rambunctious game in the same period. For an 8-hour day care day, that leaves 2½ hours for education. If the child is in a center for longer hours, another meal (usually breakfast) will have been served or, if his mother is particularly late to get him, an additional nap is likely to have been taken. The reasonableness of this kind of schedule will be

⁶⁹ The available data from the Westinghouse-Ohio State study of Head Start and other studies are well summarized in Day Care Policy Study Group, *Alternative Federal Strategies Final Report: Part II*, I (1972), pp. 135-169.

⁷⁰ Blanche Bernstein, "Costs of Day Care: Implications for Public Policy," *City Almanac*, VI, No. 2 (August 1971), p. 3.

⁷¹ Unpublished data from the General Accounting Office.

immediately apparent to any parent who has watched a preschooler fill his day.

That still leaves a couple of hours for the enriched day care that child-minders and babysitters are believed unable to provide. What happens? The children are read to, they sing, paint, or play with clay, they may learn the alphabet or how to count, or they may not; they may watch "Sesame Street" on television, polish silver, learn to tie their shoelaces, wash their tables and chairs, stuff turkeys, and so on. They may bake bread or cookies, or care for fish, turtles, rabbits, guinea pigs, house plants, or gardens, if there is enough money for these activities.

TABLE 7.—*Typical preschool schedule*

7:30- 9:00 a.m.	—arrival, breakfast for those who have not had it, health check, free play
8:30- 9:30 a.m.	—free play—Children settle into areas of their own choice: block building, housekeeping, art, science and water play, carpentry, quiet corner of books, puzzles and table toys. Teachers go from place to place observing, guiding, commenting and keeping materials available.
9:30- 9:45 a.m.	—structured activity—Teachers introduce a group activity to expand some aspect of free play, to continue a "project" of the previous day or to prepare for a trip, holiday or other new event. Some children may be too engrossed in free play to participate; others may welcome an obviously teacher-directed activity—a bingo game with large house numbers, a group collage, "writing" a story about what they have been doing or cooking jello or popcorn, etc.
9:45-10:00 a.m.	—clean up of room, washing and toileting before snacks
10:00-10:15 a.m.	—morning snack
10:15-10:35 a.m.	—music, singing, dancing, rhymes
10:35-10:55 a.m.	—story time—The teacher may read or tell a story or the children may want to tell their own tall tales or dramatize a story.
10:55-11:55 a.m.	—outdoor play—or neighborhood walk
11:55-12:00 a.m.	—wash and toilet before lunch
12:00-12:30 p.m.	—lunch
12:30- 1:00 p.m.	—wash, toilet, brush teeth and settle on cots
12:45- 1:15 p.m.	—soft listening records—folk, pop, classical, etc.
1:00- 3:00 p.m.	—children rest, usually sleep. Teachers do not sleep. One remains in the room while others take free time.
3:00- 3:30 p.m.	—waking, toileting, washing, snack
3:30- 6:00 p.m.	—indoor and outdoor free play, small group activities, departure.

Source: National Capital Area Child Care Association, *Handbook for Parents* (Washington, D.C., 1972). The program described is a developmental program completely funded by the Federal Government.

While there is no doubt that day care centers with such programs are expensive, there is some question as to whether they do more than keep children occupied (and, therefore, better behaved) and build up their self-confidence. Developmental day care cannot be defined so as to make it impossible for any mother or child-minder to provide it, given a bit of understanding and a bit of money. More money is likely to mean more turtles and house plants, not more education.⁷² And on the other hand, over half of those ill-paid givers

⁷² At a center the author visited in Anacostia (D.C.), a 4-year-old girl was making a precocious attempt at writing her numbers and had gotten to four when the teacher (a trained teacher) told her to get back to coloring Christmas wreaths.

of family day care taught the children in their charge songs, the alphabet, and how to count.⁷³

But any standards which copy those used by school systems cannot define the kind of care being given by the large number of highly qualified staff they require. The amount of time the child is spending with the educated adult cannot be determined by the rules; what he is doing with that adult during that time is even less susceptible to regulation. His development may be advanced, or it may not be. And different experts advance a child's development by very different and often contradictory techniques.

The variations in care-giver behavior in different centers operated under the same program can be very striking. The author visited two centers operated within two blocks of each other in the same model cities area of Washington, D.C. In the first, children were required to keep quiet with their hands in their laps as snacks were served and to say grace before eating. A child (age 3) who spilled her juice was not allowed to have a second cup. By contrast, in the second center (the latter was operating in a church building while the former was not) children were allowed to behave in a relaxed fashion just before eating and an exceptional amount of rudeness, bad language, and messiness was tolerated. Both centers were operated by the National Capital Area Child Care Association, with highly trained and professional staff, few children per care-giver, the best in available equipment and a cost (paid for by various Government agencies) of over \$2,000 per tot, per year. Which teachers were right? Under which approach were children getting the most enriched care?

Possibly because there is no definable technique for enriching the care provided to small children, HEW regulations for developmental day care (as opposed to standard or acceptable care), stressed the child-to-staff ratio as the key to the definition. It is certain that this factor is highly significant in differentiating the costs of various kinds of center day care (since some 80 percent of the costs of day care go to staff salaries). However, HEW's draft 1972 standards, which propose to establish reduced but still high staff ratio guidelines for family day care homes, and most State regulations for licensing day care homes, are stressing the one aspect of family day care arrangements which is not subject to criticism. Ratios not in the child's interests are frequently found in day care centers run as a private business for large numbers of children.⁷⁴ In family day care homes, according to one survey, the adult-child ratio was 1 to 5 or less in the majority of homes and in only 8 percent of the cases was it 1 to 8 or higher.⁷⁵

The average enrollment in family day care homes was 1.6 children (to which often should be added the child-minder's own children) implying adult-to-child ratios of 1 to 4 or less.⁷⁶

⁷³ Westinghouse-Westat, *Day Care Survey*, p. 98. It should be recalled that these are the same day care mothers who are paid an average of 60 cents an hour (total) and only 10 percent of whom are licensed.

⁷⁴ Keyserling, *Windows on Day Care*, p. 109; Westinghouse-Westat, *Day Care Survey*, p. 16.

⁷⁵ Keyserling, *Windows on Day Care*, p. 138.

⁷⁶ Day Care Policy Study Group, *Alternative Federal Day Care Strategies*, pt. I, (1972), p. 43; Westinghouse-Westat, *Day Care Survey*, p. 97.

To sum up, as found in private for-profit day care centers, ratios of 20 or more children per staff member (a tempting alternative given the fact that salaries amount to 70 percent of such centers' costs) may result in deprivation to the children. However, staff-to-child ratios in family day care homes appear to be lower than those in nonprofit day care centers, even of the most expensive and heavily subsidized kind, and regulations regarding the ratios will do nothing to insure even that the minimal educational activities these age groups are able to handle will, in fact, be provided. For the bulk of American preschoolers (between 82⁷⁷ and 97 percent⁷⁸) who are in family or other home arrangements, regulations on staff ratios are inapplicable. The care may be developmental or abominable, but within limits the number of children per adult may have little to do with which it is. Parents using private nursery schools generally tolerate a 1-to-10 staff ratio, which also is used in Danish day care centers for educational activities.⁷⁹

Another bureaucratic way to define developmental care is to require a certain education of the staff. It will be recalled that the New Deal day care centers were developed to put unemployed women teachers to work. The most recent draft Federal Inter-Agency Day Care Standards require that care-givers (in day care homes or the child's own home) be able to read and write. Centers with 30 or more children must have one staff member there at least half the time with a B.A. and 12 semester hours in child psychology or a related area, or a high school diploma and 3 years experience, or certified as a child development expert under Federal or State programs. This replaces the earlier, more stringent educational requirements in the 1968 standards.⁸⁰

In practice, even comprehensive centers (as defined by the Westinghouse study) do not rely heavily on specially trained staff; only 18 to 22 percent of day care center staff are college graduates.⁸¹ The teacher qualifications factor is nearly as important as the child-to-teacher ratio in fixing day care center costs. William Prosser has calculated that the per child cost of center day care will go up (at acceptable child-to-staff ratios) by as much as 67 to 80 percent if the staff are required to be public schoolteachers rather than high school graduates.⁸²

Once again, it should be pointed out that if developmental day care is defined in terms of high qualifications for the staff, it will be beyond the means of most parents and too costly for a generalized Federal program. At the recommended 1-to-5 ratio of the 1972 requirements, day care with a staff of college graduates only will cost \$1,968 per child

⁷⁷ Westinghouse-Westat, *Day Care Survey*.

⁷⁸ Vermont-Mathematica, *Vermont Family Assistance Plan*.

⁷⁹ Grotberg, *Day Care*, p. 12.

⁸⁰ Day care professionals seem to agree that the 1972 HEW standards have reduced the level of experience and education required from caregivers and have effectively increased the child-to-staff ratio. HEW counters by arguing that the new regulations cover family day care as well as group and center care, and that, contrary to earlier rules, volunteers may not be counted (they are often unreliable). HEW has abandoned the distinction made earlier between acceptable, minimum, and developmental care, although it is clear that the new standards would fall somewhere below the levels set for acceptable care in 1968.

⁸¹ Westinghouse, *Summary Report and Basic Analysis*, p. 75.

⁸² Office of Economic Opportunity, *Day Care in the Seventies*, p. 19.

per year, and with public teachers only will cost \$2,694 per child.⁸³ At that cost, the Federal Government cannot provide day care for more than a few underprivileged children.

In summary, developmental day care is hard to define except by high-priced standards which in any case do not necessarily mean that development is being encouraged in any meaningful or lasting way. The standards are not now being applied except for a tiny minority of the children receiving care.

OTHER HIDDEN COSTS AND BENEFITS

This little piggie had roast beef,
This little piggie had none,

Are day care centers a good vehicle for providing services to welfare or other low-income mothers and their children?

Children in federally funded day care centers get at least one square meal a day. They often get medical and dental checkups and care. Until the new standards are promulgated, social and psychological services theoretically must be provided the children and their mothers through the centers. All these services may be needed but they are not directly related to the goals of child care. If the alternative to their provision through day care centers is their absence, it seems reasonable that they should be provided, although the cost should not be imputed to operation of the center. However, it should be noted that most of the children who could benefit from services are not in centers, as demonstrated earlier, but in family day care arrangements in their own home or someone else's.

Thus, a program which provides services only to children in centers reaches only a small fraction of the children who could benefit from them. Unlike the much-touted intellectual development programs of preschool centers, there is no doubt whatsoever that children benefit from medical care and decent food. But the provision of federally funded services through centers—to say nothing of provision through family homes—is inequitable if not inefficient. Why should delivery of social or medical services depend on whether or not the child's mother works? It is irrelevant as a definition of need.

While medical services often are not being provided, in contrast to the World War II situation children in federally funded day care centers are never charged for the meals and snacks they eat. Some of their older brothers and sisters also receive free school lunches under the free meals programs. However, since many of their mothers are eligible for or receiving food stamp subsidies which cover the food which these meals would use (the food stamps welfare families are eligible to purchase at a varying discount correspond quite closely to a reasonable food budget of any family that size), the result is that overlapping programs have created a possibly unnecessary subsidy for some families.

In this country, social, medical and psychological services have always been provided on a family-by-family basis. This is even more true of food. An alternative delivery system can be justified on philosophical grounds, but under current practice it is not particularly

⁸³ Ibid.

efficient at meeting real needs wherever they occur. When medical needs arise out of the day care situation itself (the need to inoculate against childhood diseases), it is almost inexcusable that they are not provided through the day care center, if necessary with parents reimbursing the costs of the vaccine or the medical assistant. Other medical needs probably are filled more effectively by general programs.

Any center will have a food program (although parents may be charged for it) and a minimal medical program (for illness and injury which occurs during the day, and in some cases, for the care of sick children). Starting with these essentials which must be provided through the center or family day care home, a generalized food and medical program will probably be inefficient, and it will be inequitable as long as only day care patrons are served. It conflicts with general food and medical programs aimed at the target poverty population and adds to its cost. The food stamp and medicaid programs for all low-income earners of this country and their children would seem to be a sounder approach to the problem of hunger and ill health associated with poverty. Concentrating on the children in federally funded day care is likely to foster a false sense of accomplishment, and may interfere with the broader goal. It is estimated, for example, that all day care-linked child development components (education and health, dental, nutrition, psychological, and parent education services) would reach only 23 percent of the target population of disadvantaged schoolchildren under H.R. 1 as proposed by the administration, and only 7.5 percent of the target population in H.R. 1 as it passed the House.⁸⁴

It is worth noting, perhaps, that some other social services which one might reasonably expect day care centers to provide are not being provided. Many welfare children come from fatherless households. Yet very few people working in day care are men, although it certainly would be desirable for these children to have a man with which to identify.

Second, few day care centers provide transportation to and from the center, largely because the hours mothers work vary so greatly, as do their places of work or residence. The average child in day care is looked after for over 8 hours, and the strain upon the child and his parent of a return journey by public transport can be imagined.

The importance of distance is pointed out in the Massachusetts interviews, in which 58 percent of the respondents said they would rather pay \$15 per week for child care for all their children next door while only 33 percent of the parents were willing to use free day care 30 minutes traveling time away.⁸⁵

Third, day care centers usually do not look after sick children. The danger of infecting the other children (always great in large institutions) is the main reason for this. About 14 percent of the children attending centers are absent at any time. Not all of them are sick, of course, and there probably is a tendency for mothers using day care to keep home a well child if a sibling also in a center is ill (because of transportation problems, and because she has to stay home from work in any case). But the average 3- to 5-year-old can be counted on to

⁸⁴ Day Care Policy Study Group, *Alternative Federal Day Care Strategies*, pt. I, p. 70.

⁸⁵ Richard R. Rowe, *Child Care in Massachusetts*, p. 12.

have eight and one-half colds per year, 3.1 of them with fever.⁸⁶ The high absenteeism among preschoolers also points up the lack of realism in very low staff-to-child ratios. If average attendance rather than enrollment were used as the denominator, permitting centers to overenroll slightly, the per child annual cost can be reduced by 10 percent or more.

Finally, as has been noted earlier, federally funded day care centers do not always care for children during all the hours required by their working parents. While one study has shown that only 0.32 percent of the children of working mothers under age 6 look after themselves all day, a large number of children⁸⁷ look after themselves part of the day. That is because center hours do not correspond to the mothers' work and travel time. Only 33 percent of the children aged 2 to 5 were in day care for over 9 hours per day although 59.8 percent of the working mothers (in the same survey) were away from home 9 hours or more.⁸⁸ In most cases, alternate arrangements are made (relatives, brothers and sisters, fathers, and neighbors babysit for these children). Day care centers are inflexible (and insofar as they are outgrowths of Head Start they often are part-time arrangements). They are not solving all the child care needs of the families using them. Some 17 percent of working mothers must leave the house before 7 a.m.; another 22 percent returned after 7 p.m. Furthermore, few centers are open Saturdays, although Vermont-Mathematica found that many poor parents must work Saturdays. Few centers are open at night, although some children need care at night. And some centers close for the summer, but children of working mothers, of course, do not disappear in the summer. These failures in the programs are closely related to the concept of education that crops up so often among the day care community. Modeling their programs on the schools (teachers, after all, are not used to working in the summer or after 3 p.m.), means their programs are not filling real needs. Most Head Start programs are part time, and they are also the most concerned with intellectual development. In practice there is a trade-off between day care meeting parental needs and day care for development.

It is probable that the apparently widespread parental preference for in-home care is itself based on a perception of needs which center care does not fill. There have been relatively few attempts to correlate the real problems parents face when using center care and their preference for family-type arrangements. One recent study attempted to relate the two specifically, and found that 94 percent of the sample of upstate New York employed and unemployed welfare mothers felt that centers could take care of sick children less well than in-home care (family day care). The home situation was also considered vastly preferable on grounds of "personal attention" to the child, caring for the child the way the mother wants, and convenience "in hours and location."⁸⁹

⁸⁶ Ann DeHuff Peters, "Health Support in Day Care," Grotberg, *Day Care*.

⁸⁷ Keyserling *Windows on Day Care*, p. 13; Westinghouse-Westat, *Day Care Survey*, p. 121.

⁸⁸ Westinghouse-Westat, *Day Care Survey*, pp. 120, 161.

⁸⁹ Feldman and Feldman, *Effects on the Family*, p. 245. According to unpublished Westinghouse-Westat data, family homes were much more likely to accept sick children than centers.

If day care centers are to appeal more widely to the population in need—and if we are to focus Government efforts on financing them—the refusal to take sick children will have to be modified, particularly with regard to noncontagious sicknesses, common colds, and illnesses of long incubation period (like chicken pox) to which the rest of the center class probably would have been exposed already. Massive inoculation of the children against childhood diseases should be practiced where possible. Problems of hours and location are less susceptible of solution given the constraints of costs. And, busing of children to and from centers may be impractical given the different hours mothers work and the large areas from which day care centers draw their clientele.

Are There Hidden Benefits From a Day Care Program?

There are three groups that might benefit from day care without it being immediately apparent in the balance sheets: the mothers, the children, and society. The benefits to society have already been discussed implicitly and will be discussed at greater length in the section on welfare reform. Suffice it to say here that the main advantages to society of day care would be in support of the work ethic and a highly dubious possible reduction in social problems. The benefits to the children are also difficult to state with any exactitude. Children do not appear to gain any lasting benefit in their school work from even the most enriched programs; the effects on their personalities may be positive (above all in ego reinforcement) and they may be negative (maternal separation). The most important effect of day care would be on the mothers, particularly their availability for work.

We have already indicated that the number of women who would seek work, were acceptable day care available for their children at a price they could afford, might not be as high as opinion poll-type surveys of nonworking women might lead us to believe. But for those women who decide to seek work because day care has been made available, there are still many problems. They must find jobs in which they earn enough for it to make economic sense to work. It should be recalled that, hour for hour, women's work in this country is paid at 60 percent the rate paid men, according to Department of Labor statistics,^{89a} and the rate is declining slightly. In most cases, then, going to work at a full-time job is less advantageous economically to women than to men.

These facts of American economic life ought not to lead us to abandon those in need of day care; they ought only to remind us that a lot needs to be done beyond the mere provision of day care.

Without structural changes, the short-run effect of the entry of newly liberated mothers on the labor market would be to depress wages. While in an ideal world the effect would be felt by all workers, in our world the effect would be most severe on women already employed than on working men. Census data show that the jobs which would be taken by women who do not work now because of child care problems, were these problems solved, would correspond quite closely

^{89a} Victor R. Fuchs, "Differences in Hourly Earnings Between Men and Women," *Monthly Labor Review*, vol. 94 No. 5 (May 1971), p. 9 ff. The figure is derived from data from the 1960 census and is corrected for color, schooling, age, and city size.

to the job distribution of women already employed. The new entrants would erode female wages more than male wages.^{89b}

In the last 20 years, the number of women at work rose 70 percent while men at work rose only 15 percent. But the new entrants went into "women's work," with the following result between 1950 and 1970:

* * * there was a very great increase in the number of women clerical workers: they more than doubled their numbers. About one quarter of women workers were in the clerical category in 1950, and by 1970 more than one in three working women were clerical workers. There was no change in the nature of the economy to require such a dramatic upsurge in clerical employment. * * * These extra women were absorbed through the classical mechanism of a flexible economy—clerks lost ground in pay, and took on lower priority work. That clerical jobs of a type filled by women became relatively overcrowded is shown by the fact that during this period, wage rates in this relatively poorly paid occupation lagged still further behind all other occupational groups for men and women.^{89c}

Dr. Bergmann explains the tendency of women to enter certain kinds of jobs by a theory of occupational segregation, which results in low wages for women. Objective characteristics ascribed to women workers (turnover rate, absenteeism) are found to be less useful as explanations.^{89d}

Short of a nondiscriminatory job market, it is not certain that mothers will benefit greatly by the mere fact of being able to work because day care services are being provided their children. Some supporters of day care in fact may favor it precisely because it will create a pool of women employable at low wages.^{89e}

In the case of welfare mothers, discrimination on grounds other than sex often comes into play. Racial discrimination is an obvious factor. In addition, younger women are often subject to categorization upon hiring, and have a higher unemployment rate than young men or older women. Younger women of course are more likely to have children of the day care age group. Furthermore, 53.7 percent of welfare mothers are under 25 years old. Women under 25 have an unemployment rate of over 10 percent.^{89f}

From the point of view of particular women, or women in the work force generally, the provision of day care should be viewed as a mixed blessing. Unless a wholesale provision of day care were coupled with

^{89b} Low and Spindler, *Child Care Arrangements*, p. 9. Although there are 250 distinct categories of occupation listed by the census, one-fourth of the employed women work in five of them: secretary-stenographer, household worker, book-keeper, elementary or secondary school teacher, or waitress. cf. Janice Hedges, "Women Workers and Manpower Demands in the 1970's," *Monthly Labor Review* (June 1970), p. 19.

^{89c} Barbara R. Bergmann, "The Economics of Women's Liberation," *Challenge* (May-June 1973), pp. 12-13.

^{89d} Barbara R. Bergmann, "Labor Turnover, Segmentation and Rates of Unemployment," unpublished speech available from Dr. Bergmann, director, Project on the Economics of Women, University of Maryland, Nugent House, College Park, Md.

^{89e} Cf. Dean W. Morse, "The Peripheral Worker in the Affluent Society," paper delivered to the Industrial Relations Research Association, *Monthly Labor Review* (February 1968), p. 17 ff.

^{89f} U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings*, vol. 19, No. 5 (November 1972), p. 27; U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, *Services to AFDC Families* (Washington, D.C., 1971), p. 137.

a concerted effort at eliminating job discrimination and female castes within the labor force, women would not be all that well served by such a program.

Do Day Care Centers Have Harmful Social Effects?

Even if we assume that the inadequacies of current day care centers regarding the sex of teachers, transportation, care of sick children, and inappropriate hours were solved, the concentration on center care has had the effect of creating a racially and economically segregated class of day care users. At a time when court actions are enforcing more integration of the schools, we are developing mostly single-race day care centers under Government auspices.

According to unpublished Westinghouse-Westat data, 67 percent of the profitmaking centers had more than 90 percent white enrollment; of nonprofit centers, 39 percent had less than 10 percent white enrollment. Nonproprietary day care centers have black majority enrollment in 57.5 percent of the cases plus an additional 9.5 percent with majorities of other nonwhites. Proprietary centers (profitmaking) with white majorities make up 78 percent of total cases, while centers with black and other nonwhite majorities are only 15 and 7 percent, respectively. Under one-third of the children in nonprofit centers are white.⁹⁰

Similar segregation occurs by income. Something like 56 percent of the families of children in profitmaking centers have incomes over \$10,000 per year. On the other hand, some 74 percent of parents using nonprofit centers had incomes under \$8,000. The largest number had earnings between \$2,000 and \$3,999.⁹¹

Given the high costs of extending "developmental" programs to all low-income areas, most supporters of massive Federal funding for day-care centers implicitly settle for economic and racial segregation in these programs. While under the 1972 standards centers receiving Government funds may not overtly practice segregation, de facto segregation by race and class exceeding what would be tolerated in the regular public school system is quite common.

The first danger of this kind of segregation is that the Government is fostering it. This flows against the trend toward free and universal public education and termination of school segregation by race.

A second danger in providing a service to poor children only has been pointed out by Representative Shirley Chisholm:

All of us are vividly aware of the splits and tensions in this country between the poor and the working class. The lazy bums on the welfare dole vs. us middle Americans of the silent majority is the jargon this battle is currently cast in.

Let's not aggravate those tensions. The poor and the working class have the same needs and the same problems. Low wages, inflation, lack of job opportunities, poor educational resources, frustration with the impersonal bureaucracy, and the lack of day care facilities—they are the same problems.⁹²

⁹⁰ Westinghouse-Westat, *Day Care Survey*, p. 33.

⁹¹ *Ibid.*, p. 132.

⁹² "Statement of Congresswoman Shirley Chisholm before the Select Subcommittee on Education of the House Committee on Education and Labor on Preschool Education and Day Care" (Mar. 4, 1970, proc.), p. 6, as cited by Charles L. Schultze, et al., *Setting National Priorities the 1973 Budget* (Washington, D.C.: Brookings Institution, 1972), p. 282.

But segregation by class and race is not the only possible undesirable result of a massive day care center program. Although we have carefully excluded children under 3 from the kind of full-day care we are discussing, in practice a certain number of such babies are in center programs. There is potential psychological damage to them. The same thing might be argued about older children in center care, and certain kinds of at-home care. The simple fact is that we do not know enough about the effects of day care on children. For example, there have been no longitudinal studies of the World War II day care population now that they are grown up. The benefits to the child or his parents of center day care are unknown once we move beyond the provision of food or medical care into psychological or social benefits. The costs to the child or his mother are equally unknown. There are experts with impressive qualifications on both sides of these issues.

The possible social costs of subsidized day care centers go well beyond the dollars and cents being spent. Attempts to limit the extent of the program coverage carry in their train inequities and undesirable incentives. For example, if subsidized day care slots are limited to children of welfare mothers and WIN trainees entering the job market for the first time, other low-income mothers who have been working longer are discriminated against. The inequity would create an incentive for getting on welfare before seeking a job, similar to the current welfare system's incentives to do the same thing under the \$30 and one-third rule. If only women heading their families were eligible for day care, it would discriminate against intact families of similar income level and add to the incentive for family-splitting that exists under current AFDC rules.⁹³ If some sort of income cutoff is used to target the program on the needy, a sliding scale of charges would have to be established in order to avoid an earnings disincentive at the cutoff income level: that is, to avoid a situation in which persons \$1 below the eligibility level receive totally free day care and those \$1 above the eligibility level must pay the full cost of their children's care. If the program is not to be very expensive, the charges would nonetheless have to rise steeply with income. For example, if day care worth \$2,000 is provided free to persons with \$4,000 of income and the subsidy is reduced by 50 cents for each dollar of earnings above that level, then the subsidy would not be completely eliminated until earnings reached \$8,000. Since the benefits are reduced sharply (50 cents for each dollar), increased work efforts are not encouraged, because the family would receive so little gain.

If this benefit-loss rate seems too high, it could be reduced to 25 cents in day care fees for each dollar of earnings above \$4,000, but at greater program cost. In this case, families up to \$12,000—above the median income—would get a subsidy. Giving a day care subsidy to all such families would be expensive. Further, even this day care fee schedule, in combination with social security and income tax rates, would result in little gain from working for persons

⁹³ Women already on AFDC can deduct the first \$30 of their monthly earnings and one-third of the remainder before their AFDC payments are computed. This rule allows women to achieve earnings ranging up to \$10,000 in some States and still remain on AFDC. Working women never on AFDC, however, are not permitted to deduct the \$30 and remaining one-third from their earnings to establish eligibility. Thus, there may be two women earning \$4,500, one of whom lives on that alone, and the other of whom also receives an AFDC payment.

receiving other need-based public welfare benefits, thereby creating a work disincentive.

It ought not to be assumed that day care subsidies are only minor portions of the total amounts spent on welfare households. In a recent study of welfare household benefits at six sites, it was found that in all households receiving public assistance (including aged families and those with only older children), and not including the very important day care expense allowances to AFDC mothers, day care at its cost to the supplying agency amounted to 12 to 18 percent of the cost of benefits received by welfare households (depending on the site.⁹⁴ Day care is taking a lot of the money this country is spending on the poverty population.

Similarly, it was found by a recent survey of nonprofit centers that 62 percent of their funds came from Federal, State, and local government. Public assistance alone paid the total fees in 17 percent of day care centers, and part of the fees in another 6 percent of centers.⁹⁵

Is Government Sponsored Day Care Needed for Welfare Reform?

Various welfare reform proposals of the last few years have included a work requirement for the mothers of children aged 6 or over. Among them are the administration's family assistance plan of 1969 and 1971 (as reported out by the House Committee on Ways and Means) and the welfare reform bill reported out by the Senate Finance Committee in 1972. Only in the family assistance plan embodied in H.R. 1 as passed by the House in 1971 would the work requirement ultimately have applied to mothers of children below 6 (3 years of age and over).

There is a strong case to be made for the argument that if the mothers of preschoolers are to be required to work, then the Government should provide some form of day care for their children, or insure that funds are available to provide it. The alternative is that if a welfare mother takes a job, after paying for day care she may suffer a net income loss compared to when she was not working. This is inequitable. And, if the requirement is limited to mothers of children over 6, a similar obligation for the provision of care applies after school and during summer holidays for those children who, while over 6, are too young to look after themselves (under 12 years old, in most cases, for after-school care; under 14 for summer care).

In the short run, a program of providing day care to enable mothers to meet the work requirement is unlikely to save money. It does not make short-term economic sense to provide day care so that work may be required when the mother's wages or the savings to the Government do not exceed the cost of day care to the mother or the Government, although, of course, there may be other desirable side effects accruing to mothers, their children, and society if the mother works.

⁹⁴ "How Public Welfare Benefits are Distributed in Low-Income Areas, Paper No. 6," *Studies in Public Welfare*, prepared by James R. Storey, Alair A. Townsend, and Irene Cox for the use of the Subcommittee on Fiscal Policy of the Joint Economic Committee (Washington, D.C.: Government Printing Office, 1973).

⁹⁵ Westinghouse-Westat, *Day Care Survey*, pp. 92, 93.

Alice Rivlin presents the argument succinctly:

A State that pays a welfare mother with three children \$60 per week is, in effect, purchasing day care for \$20 per week, which is less than it would cost to take care of the child in a good nonprofit day care center. (Actually the children are being housed, fed and looked after for 24 hours per day, seven days per week, which no day care center does.) If such a mother participated in a training program and found a job that paid \$90 a week she might be able to support herself without welfare assistance, but she would not be able to contribute much to the costs of child care. The welfare department would probably find that it was paying more for keeping three children in day care than it had been paying the mother in welfare benefits.⁹⁶

Viewed as a child care program, AFDC or the welfare system we currently have, may be an incredible bargain:

While there may be advantages to the taxpayer in having day care cost more than welfare for the same children (in the form of support for the work ethic, say), the relationship of the costs to the benefits appears disproportionate. No benefit to society through improvement of the child's environment can be presumed unless large sums of money are spent, going well beyond the range of funds being discussed, although it is possible that children benefit from seeing a parent work. There may be advantages to the mother, in the form of seniority in her job, or getting away from the often intolerable conditions under which welfare families live, even if poor day care were provided.

If a limited amount of money will be available for day care for the welfare population, then it might be most efficient to leave it to their choice whether or not to go to work. To avoid equity problems, the day care subsidy cannot be limited to welfare recipients, but must be available to low-income families generally. To avoid undesirable social incentives and to control costs, the subsidy must be relatively low and incorporate a sliding scale, leaving part of the day care cost to parents.

Under current rules (in most States), AFDC mothers theoretically can be reimbursed totally for their day care expenditures if they earn enough. After the \$30 and one-third credit is subtracted, countable income (toward the determination of the welfare grant) is reduced by \$1 for every dollar earned. However, the mothers' expenses for day care and other work expenses are subtracted from countable income, meaning there is full reimbursement when mothers earn enough to otherwise have their welfare grants reduced.⁹⁷ However, this earnings incentive feature of the present welfare system is undermined by the heavy benefit loss rate otherwise applying to earnings by these families.

This simple reimbursement of day care expenditures hitherto has been discouraged in some cases by the existence of social services grants under title IV-A of the Social Security Act, under which the States received three times their direct expenditure for the provision of day care services to present, past, and potential welfare recipients. The AFDC credit, on the other hand, is only matchable as AFDC direct payments are, under a formula which varies by the wealth of the State but which generally only doubles the State's expenditure.

⁹⁶ Charles L. Schultze et al., *Setting National Priorities*, p. 277.

⁹⁷ For a discussion of the problem see *Income Transfer Programs: How They Tax the Poor*, Paper No. 4, *Studies in Public Welfare*, prepared for the use of the Subcommittee on Fiscal Policy of the Joint Economic Committee (Washington, D.C.: Government Printing Office, 1972).

Now that the title IV-A grants will no longer be open-ended, the States can no longer claim triple matching money for an unlimited amount of day care services, and we therefore should see a movement toward greater use of the day care expense deduction from welfare countable income. The AFDC grants to the States are open-ended, so if we assume that the States will maximize the amount of day care being provided to the welfare population, many more child care arrangements will be made privately by parents (the costs being reimbursable) rather than being provided directly by the Government. While technically the care these mothers purchase must meet Federal standards, in practice there is little policing going on by the State welfare administrations.

ALTERNATIVES

Eeny, meeny, miney, moe,
Catch a tiger by the toe.
If it hollers, let it go.
My mother said to pick this one.
Out goes Y. O. U.

Can private industry provide day care for middle-class children?

Before even beginning to discuss this question, three kinds of private industry in the day care business must be differentiated. The first is made up of all those day care mothers who, often obliged to stay home looking after their own pre-school children, look after an average of 1.6 other children at the same time, and all those other women who, for lack of other job opportunities, or because they like children, or both, set themselves up as child-minders. The huge majority are unlicensed, and even when the care-giver is related to the child some money may change hands. But even if we exclude the 47 percent of children of working mothers looked after by relatives, in-home care (in the child's home or someone else's by a nonrelative) was provided for six times as many children as center care.⁹⁸ That is easily the most significant free enterprise day care operation going on. And very little is known about it.

Of course, people mean something else by private industry. Here, too, an important distinction must be made. Some firms provide day care to the children of their employees. And some firms are in the business of providing day care. Day care provided as a service to employees is extremely expensive for the same reasons that Government financed day care is. To have the maximum desired effect in recruitment, stabilizing personnel, and cutting absenteeism, a firm's day care center would have to be developmental, enriching and attractive, and look after sick children. In practice, firms often have found that the results of their centers did not meet expectations. Center day care provided by companies in business to make money out of it cannot be that expensive, lest the price effectively exclude too many prospective purchasers.

Entrepreneurial operation of day care centers (and 90 percent of existing centers are run for profit) often seems to be favored by the spate of recent Government decisions aimed at reducing day care costs. When private enterprise in day care does not mean a neighbor or a babysitter selected by the mother, but rather a large commercial enter-

⁹⁸ Low and Spindler, *Child Care Arrangements*, pp. 92-93.

prise in the day care business, there are potential dangers. It must be realized first of all that economies of scale are difficult to achieve, and may not amount to more than 10 percent, in the case of centers handling 100 rather than 60 children, of the cost per child.⁹⁹

The main danger is that, given the difficulty of making a profit from centers, the operators will cut costs by increasing the number of children per staff member, and reducing the qualifications of staff. While we have attempted to demonstrate that a low ratio of children to staff and high staff qualifications are not sufficient to guarantee developmental day care, it is apparent that the absence of sufficient staff with proper qualifications at some point guarantees that the care given will not be developmental or even adequate. No adult looking after 20 children of ages 3 to 5 can control them, to say nothing of teaching them anything. It would take all the developmental time left (under the analysis in section 5) simply getting these children into and out of their smocks. The dangers of day care stifling child development are great if too many children are looked after by one adult.

The problem in making a profit from day care centers is that parents generally are unwilling to pay the costs of quality centers with a low number of children per staff member and trained staff.¹ So a profit-making, unsubsidized day care center probably will have to cut costs by reducing the number of teachers for the children and substituting care-givers for teachers, or go out of business. The qualifications of the staff and the ratio are the only factors which really affect the cost per child of day care, whether in centers run for profit or not.

However, once a center can no longer claim it is offering quality care, it has problems meeting its enrollment. And even a small falloff in enrollment can ruin a center business. "Inefficient utilization of capacity can increase costs appreciably. The annual cost per child can be reduced 10-15 percent by increasing the enrollment rate from 80 to 95 percent."² The center operated for profit treads a thin line between losing money by charging too much and losing customers by providing too little. Unlike some economists who argue that profitmaking centers are dangerous because it is hard for parents to judge the quality of care received by their children,³ we would argue that parents are capable of judging whether care is adequate and will opt for in-home arrangements rather than poor center care at the same cost.

Center operators run a strong risk of going out of business. The day care business in fact is in trouble. This is in contrast to the situation only a few months ago, when it was blandly stated that day care center companies were Wall Street's new "Wunderkinder," that profits could be made right from the start, and that care that would entice parents could be provided at \$600 per child-year. It was even stated that a well-run business day care center could pay less than 50 percent of its budget for staff, and that the more successful

⁹⁹ Ogilvie, *Employer-Subsidized Child Care*, p. 42; Office of Economic Opportunity, *Day Care in the Seventies*, p. 11.

¹ Cf. the conclusions of the Massachusetts survey. Even if they would like to send their children to centers offering quality care they cannot afford to do so. Cf. also Westat, Inc., *The OEO Child Development Center*.

² Ogilvie, *Employer-Subsidized Child Care*, p. 43.

³ Richard R. Nelson and Michael Krashinsky, *Some Questions of Optimal Economic Organization: The Case of Day Care for Children* (working paper, Urban Institute, Washington, D.C., 1971), p. 42ff.

would budget below 40 percent for staff.⁴ All this enthusiasm has been dampened.

The reality is less than a booming success. Center franchiser Performance Systems (linked to the Minnie Pearl fried chicken enterprise and called "chicken little" on Wall Street) sold off its centers for losing too much money; another franchiser, Four Seasons, on the basis of its nursing home experience, is in receivership. Some five franchising firms, including Gerber, have quit. Another group of corporate giants who experimented in operating day care centers (General Mills, General Foods, and Westinghouse) have pulled out. Franchisers have been sued for picking up the names of Montessori and Sesame, and for S.E.C. violations, misleading advertisements, and the usual franchiser peccadillos.⁵

It has been realized belatedly that high center staff costs are not the result of Federal extravagance, but apply also to private companies in the center business. And even positing a 1-to-10 staff-to-child ratio and no profits and charging a hefty \$1,700 per child annually, a center would lose money in its first year of operation, and not cover its losses until well into its third year of operation.⁶

As for employers running their own day care centers for employees, things are not moving as rapidly as the boomsters once predicted. Lack of participation has forced the closing of centers run by Tioga Sportswear in Massachusetts and the Wintergarden Freezing Co. in Tennessee. And the most celebrated industry-supported day care center in the United States, the KLH Child Development Center of Cambridge, Mass.,⁷ is no longer being funded by the employer company, and is about to close, after running a huge deficit while charging \$2,400 per child per year. Lessons can be drawn from KLH's mistakes, but let it not be assumed that businessmen are that much more efficient than bureaucrats in trimming costs of center care.

While other corporations are continuing to experiment with centers:

The dollar benefits of employer-subsidized child care are, at best, uncertain.

* * * Our analysis suggest that, except under unusual circumstances, savings from employee turnover and absenteeism are likely to be relatively small.⁸

On the other hand, centers may have a positive effect in recruitment of a female work force. Their construction would be likely to vary with the availability of female labor and the unemployment rate, and thus the current poor showing of industrial centers may not be conclusive. It is worth noting that right now the overwhelming bulk of industry-supported centers are operated by hospitals (which pioneered day care centers in the middle of the last century) and most of the rest are run by textile firms. Not surprisingly, these are

⁴ These statements are all taken from a series of articles on day care written for *Barron's* magazine in the summer of 1971 by J. Richard Elliott, Jr. He had originally intended to write only two articles, but the new industry appeared so profitable that a total of four pieces were produced. *Barron's*, July 5, 1971 p. 3ff; July 19, 1971, p. 5ff; Aug. 19, 1971, p. 5ff; Aug. 16, 1971, p. 11f. During the boom, a book on day care by Edubusiness sold for \$250.

⁵ "Growing Pains; Day Care Franchises Beset With Problems, Find Allure is Fading; Many Fail as Critics Attack Quality and Woes Develop With Their Home Offices," *Wall Street Journal* Nov. 27, 1972, p. 1.

⁶ Ogilvie, *Employer Subsidized Child Care*, p. 63.

⁷ Joseph R. Curran, David F. Hawkins, and John W. Jordan, *Industry Related Day Care; The KLH Child Development Center*, pt. I (Cambridge, Mass., n.d., probably 1969) is the best available study but it was written too soon to carry the KLH saga to its dismal conclusion and draw the lessons.

⁸ Ogilvie, *Employer Subsidized Child Care*, p. 9.

two industries employing large numbers of women, often at low wages, and for the performance of unpleasant work. Day care is probably a significant factor in recruitment.

The fact that corporate experience has not shown any decrease in employee absenteeism or turnover through the development of care centers is in contrast to the market surveys these firms carried out which provided the justification for the construction of centers.⁹ Much money was lost to learn that market research indicating that mothers would work if day care were available is unreliable. People do not act the way opinion polls suggest, particularly nonworking mothers.

Can Family Day Care Homes Be Expanded To Take More Children?

It is difficult to determine whether the supply of family day care homes can be expanded by Government action, by directly recruiting and possibly training people to become day care mothers or fathers, and then directing children to them. This is being attempted now by the day care demonstration program in Houston, Tex. (a program being run by the Office of Economic Opportunity, for which some data are available), and in other cities under OEO auspices, among them Newark. A recruitment program for family day care parents is being operated by the Human Resources Department in New York City. Another Federal program for using aged people (on the lines of the foster grandparents program) may be attempted in Atlanta. It is unclear from the very limited data we have whether such a program could be generalized without problems on the supply side (lack of available mothers) and without grave problems on the price side (increased cost of family day care). Insofar as the recruiters are promising mothers interested in becoming care-givers a Federal minimum wage, the kinds of low fees providers of family day care now charge cannot be replicated.

In any case, keeping the homes filled with the right kinds of children (by age) to meet Federal rules and State licensing laws has proven difficult in the Houston and New York programs. Even more importantly, the use of more homes for fewer children has led to family day care mothers earning less money than expected.¹⁰ All this goes some way to explaining why family day care homes are so rarely licensed.¹¹

Precisely because so few family day care mothers are licensed, there are problems in trying to find out more about family day care homes; the official interviewer finds the door closed. An attempt to open the door should be made, however. Before a program for encouraging the expansion of family day care at a certain price level is assumed (as has been done under several welfare reform programs, and as is being done by the 1973 and 1974 budget projections), gathering a few more facts might be in order.

⁹ Ogilvie, *Employer-Subsidized Child Care*, pp. 90, 110. Cf. also Westat, Inc., *the OEO Child Development Center*.

¹⁰ Unpublished quarterly reports on the Day Care Demonstration Program Information System of the Office of Economic Opportunity for Houston.

¹¹ The author knows of two day care mothers in Northwest Washington, both licensed, who wished to combine forces, retaining the same child-to-staff ratio. Since more than six children would have been served, they were required to meet stiffer regulations, including the installation of a garbage disposal unit as required by D.C. regulations.

The first thing to do would be to find out more about family day care homes, in which a woman, usually a mother, looks after other people's children in her home. More information should be developed as well about what happens to children looked after by nonrelatives in their own homes (by which is meant babysitters, not British nannies). In spite of the fact that it has been known since 1968, when the Low and Spindler survey was published, that the overwhelming majority of the preschool children of working mothers are in such day care, study of the subject is virtually nonexistent. The care they are receiving is not subject to much control by licensing (because few of these women are licensed). It does not appear to be subject to control by curriculum surveys because, unlike the day care centers, which write curricula but may not follow them, day care mothers do not aim to please Federal agencies. The care does not even appear to be subject to control by spending money (the available data seem to indicate that good, bad, and indifferent care are received in both expensive and cheap family day care homes).¹² Nor is it subject to control by establishing standards regarding hourly wages and staff competence, set crudely and arbitrarily, and subject to change at a bureaucrat's whim or a taste for cutting costs. Warmth and love cannot be legislated, and most intensive care-giver training programs cannot teach anyone to give it. In fact, there is evidence that there is no correlation between "warmth" and care-giver training.¹³

Probably the most important question about family day care homes, after quality concerns, which cannot now be answered with any confidence is how much the homes cost, and how this cost can be correlated to potentially expanded supply. The most recent estimates in the report by Donald Ogilvie on the 1972 HEW standards imply that family day care will cost \$1,249 per pre-school child per year. (The figure is not actually stated; the author derived it as an average from the data broken down by age.)¹⁴ In providing these data, Ogilvie essentially assumed that there were only two inputs in the family day care budget: food, and the salary of the care-giver at minimum wage. This stands in some contrast to the detailed inputs in the budgets of day care centers per child per year. However, Ogilvie's figures are supported by, but are considerably higher than, the recent estimate by Mary Rowe of \$866 per child per year of developmental care in family day care homes (or \$894 per child-year for in-home care).¹⁵ These estimates should be used with caution, not only because like all budget exercises they may be invalid, but because they are being used to justify an expanded program which may run into difficulties in recruitment. For information on the effect on day care fees of a Government program for recruiting and training family day

¹² The evidence is scanty, but both national surveys (Westinghouse-Westat, *Day Care Survey*, p. 96f; Keyserling, *Windows on Day Care*, p. 48) found no correlation between the fees of family day care homes and the quality of care.

¹³ Reported by William R. Prosser, Office of Economic Opportunity, referring to Abt Associates, *Cost Projections for F.A.P. Child Care*, prepared for the U.S. Department of Health, Education, and Welfare, Office of Child Development (unpublished, Cambridge, Mass., 1972).

¹⁴ Ogilvie, *Estimated Cost*, p. 17. Cf. table 30. Mean for 30 cities was found to be \$737.

¹⁵ Abt Associates, *Cost Projections for F.A.P. Child Care*, prepared for U.S. Department of Health, Education, and Welfare, Office of Child Development (Cambridge, Mass., 1972, proc.).

care mothers, reference should be made to the case of Denmark, where this was attempted recently. The Danish cost of living is rather lower than that of this country; currently the cost per child-year of Danish family day care homes is \$1,196 *excluding food*, but including the installation of appropriate equipment in the family day care home.¹⁶ The Danish experience leads one to suspect that Ogilvie and Abt underestimate the cost of expanding family day care homes. On the other hand, the Ogilvie and Abt estimates do allow for some cost increase over and above what people pay now.¹⁷

The main difficulty with the most recent estimates of the costs of family day care is that they are so wholly in contradiction with the data produced by the same agencies a few years ago when they were urging the expansion of day care centers. Developmental family day care was then estimated at costing \$1,423 at a minimum level, \$2,032 at an acceptable level, and \$2,372 at a desirable level (under the 1968 standards),¹⁸ a minimum of \$557 higher than the present estimates.

A part of the difference in costs is explained by the elimination of social and psychological services to children in family day care. This may be justifiable because day care is not the vehicle of choice for the provision of such services, and because in any event the cost of the services is not imputable to day care itself. A similar argument applies to medical and dental care. Less desirable is the elimination of funding for special resource teachers of art and music. Even less desirable is the elimination of funds for attempting to control and supervise the provision of family day care, or to recruit or train day care mothers. The disparity between the 1968 figures (even when not corrected for inflation) and the 1972 figures is disturbing.

Using the chart in the cost section, table 3 shows that the 1972 total cost was reached by the omission of any expenditure on supplies, equipment, maintenance, or administration, and the elimination of funds for training or supervision of family day care mothers. Social, psychological, medical and dental services were also eliminated. The total, ultimately, is reached by adding a per child sum for food to a share of the care-giver's salary (based on the maximum permissible number of children under the child-staff ratio). Even here, it turns out that the day care day has been calculated at 8 hours in order to set the care-giver's wage level; in practice, parents require 9 or more hours of day care in order to work at a full-time job.

¹⁶ Wagner, "Family Day Care in Denmark."

¹⁷ Low and Spindler, *Child Care Arrangements*, p. 11. The author surveyed a half dozen licensed and unlicensed child-minders in Washington, D.C., quite informally, and found a range of prices from \$936 to \$2,860 per year, for from 7 to 11 hours of care per day. Licensed child-minders with child care training (psychology degree, Montessori teaching certificate) charged as little as \$1.040 to \$1,500 per year in a middle-class neighborhood, and even the cheapest care (\$936 per year, with a discount for the second child from the same family) was being offered in an attractive house with garden by a competent mother who was motivated by a desire to find company for her 18-month-old child in an area where there were no other small children. All the mothers were found through advertisements in the supermarket or the neighborhood (free) advertising weekly, which is a perfectly reasonable way to advertise.

This survey was carried out by the author in November 1972. The two children were said to have been 3½ and 5, and care was to have been provided for 40 hours a week, Monday through Friday.

¹⁸ As given in Mary Rowe, "Economics of Child Care," p. 280.

Given that the family day care mother will be expected to provide care for longer hours, given that she will have to equip her quarters and amortize the costs, given that she will provide more than one main meal to a child remaining with her for over 8 hours, given that she will have to clean up after the children, almost all the inputs into HEW's 1972 standard cost estimate for a family day care home are suspect. In an effort to seem to comply with Federal minimum wage regulations, the family day care mother is presumed to care for the full quotient of children permitted under the ratios, which rarely is the case in practice. No allowance is made for equipment, telephone, utilities, or quarters (rent). This is not very sophisticated budgeting, and it is immediately apparent that a reasonable budget would yield a far higher number of dollars per child per year in costs for family day care.

When discussing the potential costs of a program to recruit, train, and establish family day care mothers, these omissions are glaring and misleading. Ironically enough, they are also unrealistic in the same way that most budget exercises, even using sophisticated models and analytically sound data, are unrealistic. Day care mothers do not work out their budgets rationally. They do not suppose that they must be paid the minimum wage, or the full costs of incidental food, equipment, and overhead. That is why family day care homes charge within the range of fees that parents can afford. In my informal survey of family homes in a middle-class residential neighborhood of Washington, D.C., the mean per child fee for family day care was \$25 per week with a discount for the second child. In Pasadena, Calif., where one of the most valuable surveys of family day care homes is taking place, the weekly range of fees was from \$7 to \$22.50 per child per week.¹⁹ The average was \$15.11 per child per week (\$786 per child per year).²⁰ A survey of family day care in the Southeast found that fees in family day care homes averaged \$16.61 per week (\$848 per child per year).²¹ These surveys of what is occurring in the existing day care economy are virtually the only data with which to interpret the budgets now being urged upon us. Now that the day care center has been seen to have problems—especially in regard to costs—we are being urged to turn programmatic efforts toward setting up day care mothers in business throughout the land. Until better data on costs are available than the HEW budget tables, a crash program in family day care should be delayed.

In the hope of filling some sort of data gap and to show the range that exists in the real world, the following tables showing the budgets of day care mothers in Pasadena, Calif., and environs, are submitted. It will be noted that none of the day care mothers earned the minimum wage, although one of the 25 came close. Three of the mothers lost money by looking after other people's children. As long as a Federal program requires day care mothers to be paid the minimum wage, it cannot replicate the cost levels of existing family day care arrange-

¹⁹ Sale, *Open the Door*, p. 6.

²⁰ *Ibid.*, p. 73.

²¹ Eva Galambos and Janet Smith, "Fees and Costs of Family Day Care Mothers," *Southeastern Day Care Bulletin*, No. 5 (December 1971). Published by Southeastern Regional Educational Board, Atlanta, Ga. The Southeastern Day Care project is a 3-year demonstration project going on in eight southeastern States.

ments. It thus loses the main benefit claimed for day care provided by other mothers: that it is cheap.

TABLE 8.—*Weekly costs and income for 25 family day care mothers (FCDM)*

FCDM	Mean	Range
Number of children (May 1972, total 129).....	5. 16	1-12
Number of children, part-time (under 6 hours per day).....	1. 16	0-6
Number of infants, under 2 years.....	1. 6	0-3
Number of own children, grandchildren, under 16 years.....	1. 8	0-6
Food costs ¹	\$21. 21	0-\$80. 00
Utility costs ¹	1. 02	\$0. 12-3. 62
Consumable costs ¹	3. 02	. 32-11. 67
Equipment costs ¹ 77	0-3. 68
Rental/mortgage payments.....	7. 64	2. 70-13. 10
Extra telephone costs.....	. 88	0-8. 98
Wear, tear, and breakage.....	1. 99	0-9. 00
Trips.....	. 93	0-5. 77
Insurance.....	. 73	0-15. 00
Bad debts.....	. 68	0-7. 69
Other expenses ²	1. 68	0-15. 00
Average expenses.....	39. 97	7. 71-125. 01
Average income.....	77. 97	22. 50-137. 50
Average net.....	38. 00	-(35. 01)-93. 39
Average hours.....	52. 8	45-85
Average hourly pay.....	\$. 72	-(. 50)-1. 78

¹ As defined in Southeastern Survey (Galambos & Smith, 1971).

² Such things as advertising, house cleaning, back-up child care help.

Source: Sale, *Open the Door*, p. 70f.

It may be premature, given the scarcity of information, to discuss other advantages of family day care, but some of them are obvious and deserve to be stressed. The main beneficiary of family day care as opposed to center care appears to be the child. Care is provided to him close to his home, at flexible hours, by a maternal-type figure responsible for a small number of children. Most family day care mothers seem to be from intact families with husbands present; according to the Pasadena and southeastern surveys, "having an interested male in the household added much to the enrichment of the children."²² Hours can be flexible enough to meet almost any maternal work pattern. The Pasadena survey found that children were cared for as early as 5:30 a.m. and as late as 1 a.m. In family day care, according to the Pasadena study, "the early-arriving child is generally brought in his pajamas and is put back to sleep and allowed to waken when he is ready for breakfast with the family. If he is picked up late, he is put to bed after an evening meal and storytime and later transported in his pajamas to complete his rest in his own bed at home."²³ Family day care mothers take children to the doctor

²² Sale, *Open the Door*, p. 6.

²³ Ibid., p. 7.

or dentist, and even the barber. They sometimes do the child's laundry including diapers. And they take in sick children.²⁴

Socially, there are other desirable features of family day care homes. A house is not an impersonal institution. If the group is segregated by race or class, it has no more significance than that families are. Children of various ages are mixed, which gives more attention to the babies and more ego reinforcement to the older children. The needs of a whole family (including the afterschool needs of older children) can be taken care of under one roof. Existing health and social services are more easily used, since they are family directed. Parental involvement is easier to assure, and parent education (in child care and the other problems of life) often can be subtly encouraged by a mature day care mother.²⁵ Children with psychological and physical handicaps can be coped with more easily in a family setting, as can children who are immature for their ages.

The difficulty with all these conclusions is finding a role for the Government in fostering family day care directly. Equipping mothers with acceptable quarters and/or materials will be costly. Training them in child development and supervising them while they learn through doing is a costly business. (The total omission of supervision costs in the Ogilvie cost estimates is undesirable.) The cost of all these investments and inputs is hard to estimate. The New York Department of Health found that it costs \$1,080 per year to provide care when the care-giver receives \$75 per month per child for her labor and another \$15 for food. However, the costs to the agency for administration, education, training, supervision, and special resource personnel raised the annual costs per child by an average of \$650 per year. The average per child thus came to \$1,730 per year. The costs of labor for child care came to \$650 for the various specialists and \$850 for the mother actually providing the care, which may be an indication of something badly wrong with the New York City program.²⁶ However, if a Government program is going to be established for the provision of family day care, these are the cost levels that are faced.

It appears that in New York City there were problems in finding suitable quarters (in ghetto areas), not in recruiting day care mothers.²⁷ Survey data to which the usual caveats apply seem to bear this out. The Vermont FAP survey found that, while only 13 percent of the unemployed poor mothers indicated that they might look for a job outside the house, 39 percent of the mothers "expressed interest in taking care of other children for pay, if it were possible for them to receive training and other assistance in setting up care centers in

²⁴ Ibid.

²⁵ Interesting sidelights into this result are shown by the diary of a day care mother (Midge Cochran) reproduced in Sale, *Open the Door*, p. 226ff, and in Wagner, "Family Day Care in Denmark," describing the same result in Denmark.

²⁶ Blanche Bernstein, "The Costs of Day Care: Implications for Public Policy," *City Almanac*, VI, No. 2 (August 1971). These figures are distorted upward by the inclusion in the training cost component of training for the child's mother if she is unemployed so that she can herself become a day-care mother. Repeated attempts by Dr. Bernstein and the author to get a breakout of training costs between day care mothers and unemployed mothers using the day care were unsuccessful. Training unemployed women to be day care mothers might be a reasonable on-going budgetary cost, but these costs should not be included in the cost of providing day care to their own children.

²⁷ According to Elizabeth Robbins of the Agency for Child Development of the New York City Office of Human Resources.

their homes.”²⁸ In the rural-urban upstate New York poll, it was found that 38 percent of the nonemployed mothers would like to care for other people’s children.²⁹ These women prefer to remain at home, probably because they prefer looking after their own children. But they would like to be able to earn some money, too.

While we have argued all along that opinion polls give a poor indication of how people will behave in the future, they appear to be showing that nonemployed mothers of young children are more interested in providing day care than in going out to work. The only real issue is whether these women can be encouraged to set themselves up as family day care mothers without a massive, direct, and ultimately costly intervention program.

There may be a role for the Government in directing children to slots in existing family day care homes, which are underenrolled according to the various ratios. Here, in addition to the problems of the possible care-giver’s preference for a small number (average 1.6) of children to look after, the inevitable problems of licensing and minimum wages must be confronted if direct Government intervention is proposed.

Can the Government Indirectly Encourage Family Day Care or Other Inexpensive Child Care Arrangements of Reasonable Quality?

The Government may help working parents to obtain decent, relatively inexpensive child care without providing the care directly. The sections above indicate that a large scale expansion of day care centers fully financed by public funds may be poor public policy. The wisest course for the Government to follow may be an indirect one. The key elements in this strategy would be: (1) to subsidize in an equitable manner part of the costs of the child care arrangements chosen by parents; and (2) to limit restrictive, often artificial barriers to family day care. The next section examines alternative Government subsidies and proposes reforms in the existing subsidies. This section concentrates on barriers to family day care arrangements and on quality control in the context of a day care system that subsidizes care through parental choice.

The first rule in making public policy should be to avoid actions that make matters worse. One such unwise action would be to require all parents receiving Government subsidies to choose child care arrangements that meet Federal standards. Existing regulations, such as the 1968 Interagency Federal Day Care Standards and the HEW guidelines, and proposed legislation, such as the 1972 Comprehensive Child Development Act, set stringent and costly requirements. It has been shown in the discussion of the day care being provided under Government programs, especially to children of mothers enrolled in WIN training programs, that these standards are not even enforced currently. Under an indirect subsidy scheme, such standards would interfere with parental choice, particularly by requiring that certain child-to-staff levels be met and that the care-giver be paid at a level not justified by the market. In a pluralistic society such as ours, restrictive licensing and standards conflict with the desire of parents

²⁸ Vermont-Mathematica, *Vermont Family Assistance Plan*, vol. V, p. 93.

²⁹ Feldman and Feldman, *Effects on the Family*, vol. I, pp. ix, 60.

to use care (even if partially subsidized) at a level they can afford. Given that most parents can be presumed to be concerned with the welfare of their children and reasonably competent to reject poor care alternatives when they are offered, most of the requirements implicit in existing standards interfere with parental choice. Efforts can be made to increase the competence of parents in judging care (for example, by the publication of simple material to guide parents toward a certain sophistication in judging the family day care mother and her surroundings).

Licensing requirements, often more stringent on the local level than on the Federal level, are equally obstructive. If a family day care mother loses her license, she quite easily can continue to operate as before since there are no sanctions against unlicensed day care in most areas. All that has been accomplished is the spread of disrespect for the law. Only in the case of direct payments made on behalf of the Government for day care to certain children (vendor payments under AFDC, for example) is the license or lack of it an important factor, and even here, as has been shown by the WIN experience, the sanctions seem to lack teeth.

Abusive care must not be tolerated. But licensing does not serve this function. A mother who looked after 47 children in a shatteringly restrictive day care home described by Mary Keyserling was licensed and even enrolled children under a welfare department vendor plan.³⁰ Licensing authorities usually make one inspection per year. They are concerned with ratios to such an extent that they often force parents to use more than one family home for preschool-aged brothers and sisters in day care although if the nonworking mother remains home with her own children there obviously are no such restrictions. They worry about sanitation, lead paint, and tuberculosis in the day care mother, all reasonable concerns. But licensing per se does not prevent abusive care.

Perhaps coupled with a parental education program aimed at helping parents choose good care under an indirect subsidy program, there might be an attempt at stimulating parental policing of day care. Parents who have withdrawn their children from a certain day care situation because of genuine concern for their children should be encouraged to report any abuses they found. Under existing child welfare laws in most States, all citizens are responsible for reporting child abuse, even by the child's own parents. In practice, people tend not to interfere. Perhaps an indirect subsidy scheme could combine free parental choice with an obligation to report, for example, the reasons for any change in who looks after the child. This effort might help reduce abuses.

To resolve the problem of a free market in which all the facts about the commodity being sold are not known—as is the case with day care—recourse should also be made to that most simple of control devices, asking children what they did that day in Mrs. Jones' house. When we are dealing with children of the day care age (over 3 years old), they can probably tell us most of what we need to know about the quality of care they are receiving. Greater discretion is called for when babies and toddlers have been cared for by another. This may not reassure everyone that day care of an acceptable level is in fact being provided, but there does not seem to be any alternative control system which

³⁰ Keyserling, *Windows on Day Care*, p. 135f.

works either. Since day care for infants and toddlers tends to be particularly costly, a credit or voucher program would probably leave much of the expense to be borne by the parents, and would thus not greatly encourage day care for very young children.

It also should be realized that there may be a tradeoff between programs stressing parental choice (such as vouchers, tax rebates, and even the deduction of day care expenses from countable income in setting AFDC grants) and programs which stress the effectiveness of a job creation program using welfare mothers to provide family day care. All other things being equal, parents with the option of choosing relatively cheap family day care in their own neighborhoods will not pay welfare mothers to care for their children in a slum. If a Government manpower program for the employment of welfare mothers as child-minders were to provide them with training, decent quarters, and equipment so as to appeal to other working parents seeking child care, things might be a bit different. But the cost-effectiveness of such an investment by the Government has not been properly investigated and goes well beyond the scope of this paper. It should be noted that the welfare stigma is a difficult one to overcome, however. It was reported from Houston that "several homes are in a housing project. Mothers living outside the area look down on public housing residents and don't want their children in this setting."³¹

Coupled with any system based on free parental choice—which would have to permit them to enroll their children in for-profit centers as well as in family homes³²—there would have to be a greater emphasis on parental education and obligations in return for the subsidy. The subsidy might itself encourage greater parental concern by encouraging them to spend more than they now do on day care:

If parents knew what good developmental practices were, they would choose the best for their children. In the long run they are the most effective licensors. I think the only way to stop poor child care is for parents to refuse to utilize those services. Let's put some money into helping parents with their decisions.³³

A parental-choice program rather than direct Government intervention may be most effective as a method of expanding and upgrading family day care homes, which in many other respects seem superior to day care centers, particularly in meeting the needs of children. It is certainly deplorable that family day care mothers should be paid so badly for their labors, and a tax rebate or voucher system, in contrast to topheavy training and recruitment programs like the one described for New York City, will get the most cash to the woman minding the child, however inadequate it might be in terms of hourly wages. Efforts at policing, licensing, and controlling day care in the family situation seem doomed to failure, and the best control device appears to be parental choice. Reducing monetary constraints should be a good method of increasing parents' ability to reject poor care, better than a program aimed at only a fraction of the existing and potential day care population.

³¹ Office of Economic Opportunity, unpublished report on Day Care Demonstration Program Information System, including family day care, in Houston, Tex.

³² For-profit centers were specifically barred from Federal funds under the Comprehensive Child Development Acts.

³³ Sale, *Open the Door*, p. 66, quoting her log of the family day care study in Pasadena.

*What Are Current Methods of Government Subsidy to Parental Expenditures on Day Care?*³⁴

Budgetary considerations alone rule out full coverage of everyone's child care expenses. Nevertheless, it does seem appropriate for the Government to provide some help in financing day care expenses. Day care is an unusually large and continuing work expense for families with all adult members in the labor force. In the absence of some supplementation, low-income families may face heavy pressures to restrict their day care expenses and buy cheap, low quality supervision which may prove harmful to the children. Thus, the Government should subsidize some, but cannot and should not subsidize all, day care expenses.

This section describes two important ways the Government currently subsidizes day care costs.³⁵ These two schemes—the AFDC work expense credit and the Federal income tax deduction—are viewed as examples of two general methods for subsidizing day care. By documenting the problems with the current subsidies, the groundwork is prepared for the reforms proposed in the next section.

All schemes for subsidizing child care expenditures involve either a tax credit (so that dollars spent for child care directly reduce tax liability) or a tax deduction (child care costs reduce taxable income) or a combination of both.³⁶ Credits or deductions can be allowed for all or only part of each dollar spent, and the amount may or may not be subject to a maximum.

A full tax credit for child care expenditures may have some unfortunate aspects. The marginal cost to the family of spending additional dollars on child care is zero, eliminating any incentive to hold down such expenses.³⁷ Of course, if there is a limit to the tax credit, the incentive to economize would apply only over some prescribed amount.

The usual treatment of child care and other work-related expenses under AFDC operates like a full tax credit up to a limit.³⁸ As noted earlier, working AFDC recipients often find that work-related expenses are costless because they may be offset against *countable* income. If a recipient incurs \$1 more in work expenses, his countable income falls by \$1 causing his AFDC grant to rise by \$1.³⁹ Thus, work expenses act as a credit by fully offsetting the recipient's benefit loss.

³⁴ The author is indebted to Robert Lerman and Jon Goldstein for extensive help in preparing this and the following section.

³⁵ A third method—the deduction of child care expenses allowed under the food stamp and public housing programs—subsidizes child care by offering greater benefits than would be available without the deduction.

³⁶ Voucher and direct reimbursement schemes are identical to a tax credit. Even direct provision of care through a publicly operated center has aspects of a credit but clearly does not offer the latitude of choice that a credit does.

³⁷ The situation is really worse than this. A full tax credit creates an opportunity for kickbacks and, hence, an incentive to make child care expenditures as large as possible without arousing suspicion.

³⁸ This discussion does not apply to those few States that make voucher payments for child care instead of allowing child care as a work expense.

³⁹ In the seven States which pay less than 100 percent of the difference between the need standard and countable income, work expenses act as partial offsets to benefit losses. For example, the value of the credit in Arizona, which pays 65 percent of the need standard minus countable income, is 65 cents for each added dollar of work expenses. See *Income Transfer Programs: How They Tax the Poor*, pp. 13-22, for more details on State differences.

The potential size of this credit is limited by the amount of the benefit loss associated with earnings and by restrictions by the State and/or caseworker as to what expenses are "reasonable." Recipients who lose no benefits due to earnings would gain nothing by increasing their spending on child care.

The primary problem with the AFDC credit is that it discourages recipients from economizing on work expenses at all. Other problems include the wide variation among States and among caseworkers as to what recipients may claim as work expenses, and the enormous administrative burden created by the fact that work expense changes affect grant levels. These problems are inherent in the treatment of work expenses in general rather than being unique to the treatment of child care expenses. In the case of child care expenses, the credit encourages some working recipients to buy expensive child care, whether or not the higher priced care appears worth the extra cost, instead of spending on what may be more urgent needs.⁴⁰

An income tax deduction is another mechanism which relieves parents of the full burden of day care costs. If day care costs are viewed as a necessary employment expense, it is appropriate to allow parents to deduct these costs from gross income to arrive at the proper concept of net income. Deducting day care costs reduces taxable income and, in turn, reduces tax payments. The dollar savings to parents equal the deductible day care costs times the tax rate that would have applied to the last few dollars of taxable income. While the deduction does encourage parents to spend more on day care, they would continue to bear most of the cost of additional care. For example, the net cost to parents subject to a 30 percent marginal income tax rate of an extra \$1 expenditure on day care after accounting for the tax savings is still 70 cents. This leaves parents with an incentive to economize on child care expenses.

The Internal Revenue Code currently utilizes the tax deduction approach.⁴¹ Families with dependent children under 15 may deduct up to \$400 per month for employment-related expenses, including household service and child care.⁴² These expenses are deductible only if incurred to enable the taxpayer to work.⁴³ In the case of mar-

⁴⁰ In fact, working AFDC recipients do not appear to take much advantage of the incentives to spend large amounts on day care. Nearly 60 percent of mothers with earnings spent nothing on day care. Only 9 percent paid \$100 per month or more. Unfortunately, the published data do not allow one to distinguish between day care expenditures by high earners and day care expenditures by low earners. One would expect only high-earning AFDC recipients to take advantage of the credit since low earners can bring benefit losses to zero through deductions other than for day care.

⁴¹ The present deduction is based on a 1971 amendment which raised maximum allowable deductions from \$900 (for at least two children) to \$4,800 per year and raised the maximum income for receiving the full deduction from \$6,000 to \$18,000.

⁴² Families in which a spouse or other dependent is physically or mentally incapable of caring for himself also qualify. The discussion below ignores these cases.

⁴³ Allowable expenses for household services or for child care may total \$400 per month if the services are incurred inside the taxpayer's home. The monthly limits on outside child care are \$200 for one child, \$300 for two, and \$400 for four. One may combine the deductions for outside care with deductions for services inside the home to reach the maximum deduction of \$400 per month. Among the anomalies created by the distinction between in-home services and out-of-home care is that parents who are willing to do their own cleaning in order to finance higher quality out-of-home care may lose part of their \$400 deduction.

ried couples, both spouses must work “* * * on a substantially full time basis * * *” in every period for which these expenses are deducted and they must file a joint return. Another section of this provision reduces the maximum deduction by 50 cents for each dollar by which adjusted gross income of the taxpayer exceeds \$18,000.⁴⁴ Table 9 illustrates the tax savings from the employment-expense deduction at various expenditure and income levels.

TABLE 9.—*Tax saving from the child care deduction by income class, type and size of family, and amount expended for child care under Revenue Act of 1971*¹

Adjusted gross income ²	Number of parents ³	Number of children ⁴	Child care expenditure ⁵	Tax saving ⁶
1. \$4,000:				
A-----	2	1	\$400	0
B-----	1	1	400	0
2. \$5,000:				
A-----	2	1	500	0
B-----	1	1	500	0
C-----	2	2	1,000	\$63
3. \$6,000:				
A-----	2	1	600	32
B-----	1	1	600	36
C-----	2	1	300	0
D-----	1	1	300	0
4. \$7,000:				
A-----	2	1	700	77
B-----	1	1	700	83
5. \$8,000:				
A-----	2	1	400	57
	2	1	1,600	264
B-----	1	1	400	57
	1	1	1,600	282
C-----	2	2	800	119
D-----	1	2	800	131
6. \$10,000:				
A-----	2	1	500	95
B-----	1	1	500	110
C-----	2	1	1,000	190
	2	1	1,600	304
	2	1	2,400	453
D-----	1	1	1,000	220
	1	1	1,600	334
	1	1	2,400	406
7. \$15,000:				
A-----	2	1	500	110
B-----	1	1	500	125
C-----	2	1	1,000	220
	2	1	1,600	352
	2	1	2,400	578
	2	1	3,600	759
D-----	1	1	1,000	250
	1	1	1,600	393
	1	1	2,400	577
	1	1	3,600	850

See footnotes at end of table, p. 159:

⁴⁴ For married couples the deduction declines as the adjusted gross income of taxpayer and spouse exceeds \$18,000.

TABLE 9.—*Tax saving from the child care deduction by income class, type and size of family, and amount, expended for child care under Revenue Act of 1971*¹—Continued

Adjusted gross income ²	Number of parents ³	Number of children ⁴	Child care expenditure ⁵	Tax saving ⁶
8. \$18,000:				
A-----	2	1	600	150
	2	1	1,000	250
	2	1	1,600	384
B-----	2	2	1,000	229
	2	2	1,600	361
	2	2	3,200	713
C-----	1	2	1,000	270
	1	2	1,600	421
	1	2	3,200	818
D-----	2	3	2,400	528
	2	3	3,600	790
	2	3	4,800	1,018
E-----	1	3	2,400	605
	1	3	3,600	880
	1	3	4,800	1,151
9. \$25,000:				
A-----	2	1	1,000	0
	2	1	1,600	0
	2	1	2,000	0
B-----	21	2	1,000	0
	1	2	1,600	0
	1	2	2,000	0
C-----	2	2	2,000	0
	2	2	3,600	28
	2	2	4,800	364
D-----	1	2	2,400	0
	1	2	3,600	32
	1	2	4,800	413
E-----	2	3	2,400	0
	2	3	3,600	28
F-----	2	3	4,800	364
	1	3	2,400	0
	1	3	3,600	32
	1	3	4,800	405

¹ Each family is assumed to have itemizable deductions equal to 15 percent of adjusted gross income exclusive of the amount paid for child care. Thus, they would normally use the \$1,300 minimum standard deduction if their incomes were less than \$8,667 and they had no child care expenses. The families with \$6,000 or less adjusted gross income and no tax savings are cases where the child care deduction is not large enough to make it profitable to itemize. The 15 percent deduction is a standard deduction up to \$13,333; above this level it represents itemized deductions other than for child care.

² In most cases adjusted gross income will equal or closely approximate gross income.

³ Where there are 2 parents, a joint return is assumed. In the case of a single parent, head of household treatment is assumed.

⁴ In this table all children are assumed to be under 15. Therefore, the total number of personal exemptions allowed is the sum of the number of parents and the number of children indicated.

⁵ It is assumed that where child care expenditures exceed \$200 a month for 1 child or \$300 a month for 2 children a domestic worker is involved, so no cutback in allowable deduction occurs as a result of these limits on expenditure on care outside the household.

⁶ Above \$18,000 adjusted gross income the deduction otherwise allowable is reduced by 50 percent of income in excess of this amount. Thus, at the \$25,000 level only child care expenses in excess of \$3,500 are deductible.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, as cited in *Comprehensive Child Development Act*, p. 475, quoting a letter by Joel Segall, Deputy Assistant Secretary, U.S. Department of the Treasury, to Senator Walter F. Mondale.

The tax treatment of employment-related day care and household service expenditures represents the exception rather than the rule regarding work expense deductions. In general, the tax code does not single out specific work expenses because of great practical difficulties

in distinguishing consumption from pure work expense elements in such items as transportation, clothing, and lunches. Instead, the general presumption is that in the long run taxpayer families face similar amounts of ordinary work expenses. It is the recognition that this policy is unfair to families with children or disabled dependents and with all adults working that has prompted the special treatment of household and day care expenses.

Viewed in this light, the Federal income tax deduction is a method for refining the concept of net income. The limit of \$400 per month assumes that expenses above \$400 represent consumption rather than pure work expenses. Although this figure appears reasonable, it is unavoidably arbitrary and somewhat unfair. Low- or moderate-income families in which working members perform household duties at night or on weekends lose as compared to higher-income families hiring household help and enjoying more leisure.⁴⁵

Still this is not an adequate rationale for the \$18,000 income limitation. While some may argue that any help to high-income groups is an unnecessary waste of tax revenues, the income limitation, in fact, conflicts with the goal of refining net income to cover extraordinary day care expenditure. If income net of these expenses is the appropriate standard for assessing tax burdens, then high-income families with these expenses should pay lower taxes than families of the same gross income without such expenses. The desirable goal of progressivity is a separate issue from the decision to define taxable income as net of special employment expenses.

A third problem with the tax deduction is that it applies only to those who itemize their deductions. This policy is again inconsistent with the goal of refining the definition of net income. If a special treatment should apply to certain employment-related expenses of families with children in which all adults work, the deduction should depend only on family circumstances and on expenses for child care and household services. It should not matter how much the family spent on medical expenses, contributions, and property taxes. The statute clearly states that the primary purpose of the deduction is to cover certain costs of earning income. The Senate Finance Committee's report on the original 1954 amendment calls the expenses " * * * comparable to an employee's business expenses."⁴⁶ Nevertheless, the present treatment does not follow these guidelines. The primary losers are the many low- and moderate-income families which are made ineligible for the day care deduction by claiming the standard deduction.

How Can the Government Improve the Existing Subsidies to Parental Costs of Day Care?

The Federal income tax deduction and the AFDC work expense credit provide the two most important indirect Government subsidies to parents with day care expenses. Yet subsidizing day care was not the primary purpose of either provision. The AFDC work expense credit for day care spending was devised to improve the work in-

⁴⁵ See Richard Goode, *The Individual Income Tax* (Washington, D.C.: The Brookings Institution, 1964), pp. 80-81, 164-165.

⁴⁶ U.S. Congress, Senate, Finance Committee, *Internal Revenue Code of 1954*, S. Rept. 1622, 83d Cong. 2d sess., 1954, p. 36, as quoted in Goode, *The Individual Income Tax*, p. 165.

centives of welfare recipients. The income tax deduction is largely a device to refine the definition of net income. Not surprisingly, these provisions which were designed for other purposes are neither efficient nor equitable instruments for achieving the objective of aiding parents in purchasing day care. This section recommends changes that would improve the Government role in this area.

Existing subsidies of day care costs virtually fail to help low- and moderate-income families. This gap should be filled. Furthermore, the tax deduction and AFDC credit—apart from the gaps in their combined coverage—do not achieve efficiently their own objectives. The proposed legislative changes which follow would help make these problems less severe:

(1) Offer a tax credit for day care expenses to families with children in which all adults work but which do not use the existing or proposed tax deduction;

(2) Allow eligible families using the standard deduction and eligible families at all income levels to use the current day care deduction while reducing the maximum amount deductible; and

(3) Replace the current AFDC work expense credit with a deduction that is a specific percentage of earnings.

While these proposals would all be desirable as part of a reform of day care subsidies, for the most part any one can stand on its own. Instituting (3) without (1) would significantly increase the burden of child care expenditures on AFDC recipients, however.

1. THE TAX CREDIT

A *tax deduction* is appropriate for day care expenses as a method of refining the concept of net income for tax purposes. As noted above, the fact that such a deduction may not help low- and moderate-income families is irrelevant. Progressivity is a separate issue from the definition of net income.

A *tax credit* for day care expenses would be justified by the desire to transfer to certain low- and moderate-income families income earmarked for a specific expenditure.⁴⁷ The basic objectives are to help parents avoid poor day care and to provide special help to those low- and moderate-income families with children in which all adults work. Of course, this also means encouraging entry into the labor force by wives and single parents.

The tax credit would work as follows: Taxpayers who qualify for the existing or proposed day care deduction on grounds of the family situation would be given the option of receiving a monthly credit instead of the deduction. The credit would equal the lesser of (a) some percentage of actual expenses (say 40 percent); or (b) some maximum per month, say \$60. In this example, to gain the maximum credit the taxpayer would have to spend \$150 or more per month. As with any tax credit, the taxpayer's tax liability would decline by the full amount of the credit. If the credit exceeded tax liability, the Government would pay a rebate to the taxpayer.

This partial credit would relieve a share of the burden of day care costs without at the same time removing the incentive parents have to find inexpensive adequate care. Below the maximum amount

⁴⁷ Since the day care tax credit is conditional on work effort, it would not be equivalent to an in-kind transfer, but would resemble an in-kind wage subsidy.

allowed, a \$1 increase in day care expenditures would cost the parents a fraction of \$1, say 60 cents.

Turning to the choice of parameters, one meets with difficult tradeoffs. The cost of the credit will depend on the maximum amount allowed and on the percentage of expenses covered up to the maximum (hereafter, the "coverage rate"). At any desired cost level, setting the maximum will determine the coverage rate and vice versa. Given initial levels of the parameters (say, 40 percent and \$60), raising the coverage rate and lowering the maximum will concentrate benefits on those who can only afford low-priced day care but at the same time reduce the incentive to cut costs below the maximum. This would encourage those spending the least to spend more by lowering the effective price they must pay. Alternatively, lowering the coverage rate and raising the maximum will increase the incentive to economize on day care (that is, it will raise the effective price to low spenders) while showering larger benefits on those able to afford high-priced day care.⁴⁸

These are conflicting objectives. There is another difficulty concerning the decision to lower the effective price of day care. A low price (high coverage rate) is desirable in encouraging parents to avoid cheap and potentially harmful arrangements but is undesirable in discouraging parents from seeking those cost savings that do not reduce quality.

Another perspective on these choices comes from examining the effects of the current tax deduction. The maximum value of the deduction is \$85 to \$95 per month as received by families with \$18,000 of adjusted gross income.⁴⁹ To gain the full deduction these families must spend \$400 per month for day care or other household services. Thus, their marginal tax rate and coverage rate is about 25 percent; this implies that their effective price of day care is 75 percent of the market price. To these families the deduction is similar to a credit paying 25 percent of day care expenses up to a maximum credit of \$95.

A tax credit similar to the most favorable treatment accorded under the tax deduction would be extremely expensive and would not focus the benefits on target families. The goal of encouraging low- and moderate-income families to avoid potentially harmful arrangements suggests a low percentage of coverage, 50 to 60 percent. Cost considerations imply a low maximum credit amount allowed, say \$40 to \$60 per month. Thus, a modest but helpful credit would pay 40 percent of expenses up to a maximum credit of \$40 per month.

2. ADJUSTING THE TAX DEDUCTION

The current income tax deduction is in need of reform. Families with incomes above \$18,000 lose part or all of their day care deduction and families which do not itemize deductions lose all of it. These exclusions conflict with the goal of allowing the deduction as a way of refining the definition of net income. What is proposed here would adjust the tax deduction to deal with these problems along the lines already proposed by various members of Congress.

⁴⁸ For example, lowering the coverage rate from 40 to 25 percent and raising the maximum from \$60 to \$75 increases the amount one must spend in order to receive the maximum credit from \$150 to \$300.

⁴⁹ See table 9. The allowable deduction declines as income exceeds \$18,000.

Consider first the provision that allows the day care deduction only to families that itemize deductions. This is clearly inappropriate if the purpose of the day care deduction is to allow special treatment for a particular expense of earning income. Whether or not day care is purely a work expense is difficult to determine, but the question certainly does not depend on such other expenditures as property taxes, interest on mortgages, and medical bills. If day care expenses of a family in certain circumstances are considered as pure work expenses, the deduction should be allowed independent of the family's other expenditures.⁵⁰ Given that high-income rather than low- and moderate-income families have a greater tendency to itemize, this treatment favors higher income families.

One bill (S. 947) would amend the present IRS law to allow the day care deduction as a business expense. This amendment would extend the deduction to all eligible families whether or not they itemize deductions. Passage of this bill would constitute one desirable change in the current day care deduction.

The second problem cited above is that part or all of the day care deduction does not apply to high-income families. As argued above, this policy is inconsistent with the notion that the special day care expenses of families with children and with all adults working should not be counted as net income. The logic of this argument suggests that the allowable day care deduction should not decline with income.

Interpreting the effect of this change depends on how one views these special expenses. If the allowable deductions are, in fact, pure work expenses, then allowing the full deduction improves equity by according different treatment to families with equivalent high gross incomes but with different work expenses and thus different net incomes. On the other hand, the deduction is in part a transfer to high-income families to the extent that the allowable deduction is part consumption.

Concern about the consumption nature of the deduction suggests that we should be concerned with the size of the maximum deduction rather than the gross income of the taxpayer. Taking special care to exclude consumption elements of the expense is difficult but important because allowing these elements in a deduction increases tax regressivity. From this standpoint, it appears that the \$400 per month maximum deduction is almost certainly too high. This is particularly true in the case of families with school-age children. These families do not require the services of a well-paid, full-time maid as a pure work expense. Allowing the full deduction would subsidize most the leisure of families rich enough to afford a maid and allow them to reap the highest benefits from the deduction while not offering comparably generous treatment to lower income taxpayers who do their housework themselves on nights and weekends. The maximum deduction should be reduced substantially for families with no pre-school children and probably reduced by a smaller amount for families with at least one pre-school child.

In summary, the adjustments in the tax deduction advocated here are:

⁵⁰ There might be a case for allowing day care expenses only in itemizing deductions if all of the other itemized deductions allowed were expenses of earning income. But this is clearly not the case.

- a. To allow families who do not itemize deductions to claim the day care deduction;
- b. To allow families at all income levels to claim the full day care deduction; and
- c. To reduce the maximum allowable day care deduction, especially for families with no pre-school children.

3. CHANGING THE AFDC WORK EXPENSE CREDIT

The AFDC work expense credit represents poor public policy. In particular it is not a wise method for subsidizing the day care expenses of welfare recipients. And as noted above, the problems in the treatment of day care expenses are common to the treatment of all work expenses. The reform proposed here would improve AFDC policy with respect to all work expenses.

The criticisms of the AFDC work expense credit cited above are: (a) that recipients often have no incentive to economize on work expenses; (b) that the amounts allowable are subject to wide variations by State and wide discretion by caseworkers; and (c) that requiring changes in the monthly grant with changes in certain expenditures imposes an enormous administrative burden. Students of tax policy would also recognize the general problem of providing for work expenses through a specific list of items. That general problem is the high degree of subjectivity as to what constitutes a work expense and the possibilities of choice individuals have in substituting one category of purchases for another. A common example is that commuting expenses are often substitutable for housing costs. For this reason the tax law tends to avoid focusing on specific work expense items.

The ability to substitute expenditures and the subjectivity in defining expenses are particularly important in the case of the AFDC work expense credit because, to recipients whose earnings are high enough to affect the AFDC grant, an added dollar spent on work expenses is not merely deductible (from the income "taxable" at the AFDC benefit loss rate) but is refundable in full. That is, shifting a dollar from consumption to allowable work expenses costs the recipient nothing in lost consumption since the AFDC grant rises by a dollar.

It should be emphasized that the AFDC work expense credit does not provide all recipients with full reimbursement for dollars spent on allowable work expense items. Rather, reimbursements generally apply on an all or nothing basis.⁵¹ Those recipients whose earnings are too low to reduce their AFDC grants or whose expenses already have prevented any declines in their AFDC grants receive no reimbursement at all from added work expenses.

The best solution to these problems is to eliminate the AFDC work expense credit entirely while simultaneously reducing the AFDC benefit-loss rate from 66½ percent to 50 percent. This change would simplify the system greatly, would eliminate the wide disparities among States and caseworkers, would encourage recipients to economize on work expenses, and would eliminate any artificial incentives

⁵¹ The discussion here does not apply to the seven States using ratable reductions. See *Income Transfer Programs: How They Tax the Poor*, pp. 12-15.

for recipients to adjust their budgets to take advantage of provisions for full reimbursement of some forms of expenditure.

The reduction in the benefit-loss rate is necessary merely to preserve existing work incentives. Indeed, the reduction from 66 $\frac{2}{3}$ percent to 50 percent may be too small to prevent worsening incentives to work. Without a credit for social security taxes and personal income taxes, the combined tax rate in fact would not be 50 percent but more like 56–65 percent. Not allowing credits for nontax work expenses such as transportation would further reduce the net return from an added dollar of earnings. Research needs to be done on what the final benefit loss rate should be to avoid making average work incentives of recipients worse than they currently are.

What about day care? Substituting a lower benefit-loss rate for the work expense credit will eliminate the direct AFDC subsidy to day care. However, recipients who have average day care needs should find the lower benefit-loss rate helps them finance their day care needs. Further, AFDC recipients would be eligible for the tax credit subsidy; the same day care subsidy that other low- and moderate-income families would receive.

DAY CARE AND WELFARE

By MICHAEL KRASHINSKY*

SUMMARY

This paper examines how day care might be integrated with various plans for reforming welfare. The first section discusses some of the rationales for public involvement in the financing of day care. The next three sections focus on specific forms in which day care could be integrated with various welfare reforms. Some cost estimates are made. And the last section considers what Government involvement, if any, will be needed on the supply side of day care.

Those advocating public involvement in day care do so for a variety of reasons. Some see day care as primarily custodial, useful in freeing mothers now receiving aid to families with dependent children (AFDC) to work and thus reducing their welfare payments. Others see day care as a means of reaching poor children at an early age with resources to enable them to succeed in school and escape the poverty of their parents. Current discussion of welfare reforms focuses on the first motive, but clearly the widespread use of day care by the poor while they work would make the second motive much easier and cheaper to achieve.

Some public involvement in day care is essential when individual parents raising their children without the aid of a husband or wife are forced to work. Unless the net take-home income of the family is high enough, low cost and often dangerously low quality care is all that can be afforded. Yet if the cost of proper care is high and earned income low, more may be spent putting the mother to work, caring for the children, and insuring an adequate family income than would be spent simply maintaining her in the home to care for the children herself. In such cases, the work requirement will be an economically inefficient approach to dealing with poverty, unless work is seen as a virtue in itself or day care is seen as a valuable tool for reaching poor children with essential services.

In evaluating the alternatives, the notion of "standard" care is useful. Standard care is the level of day care necessary to replace care given a child at home, and should include both the physical care necessary for safety and the emotional and developmental care neces-

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sary for the proper development of the child. We assume that the home care considered is in a family at some minimum level of income. If we could define standard care precisely, its cost would represent one of the real losses incurred by having the parent work. If the value of the parent's working were less than this cost, then the work requirement would tend to be inefficient when applied to that parent.

A range can be developed for the cost of standard care which basically amounts to the range between "minimum" and "adequate" care developed by HEW in 1967. I favor the upper limits of that range, as minimum care simply protects the child physically but does little else, while adequate care also pays some attention to the child's developmental needs. However, those who favor the lower end of the range feel that the HEW figures were too cautious, and overplayed the need for costly developmental programs (the real determinant of cost is in fact the staff-to-child ratio, which is about 1:4 for adequate care and about 1:6 for minimum care).

The reader may decide just what he favors, as all calculations are done for both estimates. The cost ranges are \$1,344 to \$2,052 per child aged 3 to 5 per year, and \$372 to \$718 per schoolchild per year.

Under some form of negative income tax plan,¹ it is important to make day care expenses fully deductible (up to the cost for standard care), from earnings before benefits are calculated. This guarantees that no one will have a net income (after day care expenses) below the guarantee level, provided they can cover their day care expenses out of their earnings. This is also important for horizontal equity. However, if there is a work requirement, deductibility alone will not be sufficient. If earnings are very low and day care costs are too high, the mother may not be able to cover day care out of her earnings. In this case, family income may drop below the minimum guarantee and/or inadequate day care may be purchased. The situation can be avoided by various forms of direct subsidy for day care. I favor a proportional subsidy in which a part of each dollar spent is subsidized (while the remainder is paid by the parent and is deductible). In this way parents can afford quality day care but still have the incentive to cut costs if lower cost for a given quality day care is available (say through a grandmother or an aunt). It is also important to consider how such a day care subsidy might decline as income rises, since any decline represents an additional real tax on each extra dollar earned (if for each dollar earned the subsidy drops 40 cents, the tax rate due to this subsidy decline alone is 40 percent).

Under H.R. 1 (the family assistance plan as passed by the House in 1971), which requires parents with children over 3 years old in single-adult households to work, these issues are crucial given the high cost of pre-school care. I recommend that the work requirement be modified to excuse one-parent families for whom the expected gain from working is well below the cost of standard care. It is possible to estimate how much such an arrangement might save the Government given a subsidy scheme (for such families Government costs under the subsidy schemes will be higher than if the families were simply supported at the guarantee level). It is also possible to estimate the overall costs for day care while training is taking place,

¹ For an explanation of this type of plan and the others referred to subsequently, the reader is referred to the introduction to this volume and to the body of this paper.

costs that are also lowered if certain parents are not required to register for work.

Under the Senate Finance Committee's "workfare" proposal, where all one-parent families with children under 6 years old are exempt from the work requirement, the day care issues are similar but less important. Some form of subsidy will still be needed. But since the bill (H.R. 1, as reported out of the Senate Finance Committee in 1972) envisions the mothers themselves taking Government guaranteed jobs to provide day care, a parent with a large family may simply end up being paid to care for her own children. Some cost estimates for care may also be made under such a plan.

A universal demogrant amounts to a negative income tax without a work requirement. As such, I recommend deductibility of day care expenses, but no subsidy.

Given a wide expansion in the demand for day care, what public intervention might be needed in supply? The great difficulty that parents have in properly evaluating the day care they purchase and the great potential danger to children from low-quality care leads me to be somewhat wary of profitmaking private enterprise, as the dominant organizational form in the sector. On the other hand, public provision of day care might not have the flexibility of supply needed in an industry where individual demand is so unstable. I recommend the encouragement of nonprofit firms. Whatever forms are used, I advise that they be required to be open and responsive to parental overview. The Government might also help mothers to form day care centers of their own, providing them at cost with the capital and organizational skills necessary for success.

INTRODUCTION

The various reforms in the welfare system currently being considered involve a significant shift in the approach to care for young children. In the past, it has been felt that children required a parent in the home full time, well beyond the first years of life. In single-parent families, AFDC (aid to families with dependent children) provided financial support to enable the mother to remain at home with her children until they were well through primary school. Although the mother might work, it was generally assumed that she would not, and in fact the system discouraged work.² The new reforms, however, imply a different approach, one more tolerant to the shifting of child care away from the parent.

The universal demogrant plan (UDP) would reduce the large work disincentive now facing a mother in a one-parent household receiving AFDC. Both the "work fare" proposal advanced by the Senate Finance Committee and the categorical negative income tax passed by the House of Representatives in 1971 (hereinafter referred to as H.R. 1) go even further. They both require work of mothers, whose children are past a minimum age, on penalty of loss of assistance (the Senate Finance Committee's proposal would enlist all mothers in single-parent households with no children under 6 years of age; the House bill extends that age limit down to 3 years of age.)

² Before 1969, assistance in many States decreased a dollar for every dollar earned, while after 1969, recipients could keep at least one-third of each additional dollar earned.

Where there are strong incentives for mothers with young children to work, there must be some concern for the alternative arrangements that will be made for care for these children. This is especially the case in H.R. 1, and only slightly less so in the SFC proposal, since the largest group of employable but currently nonworking poor targeted by both reforms are mothers with young children and no husbands in the home. In this paper the three reforms mentioned above are discussed in order to determine how day care for children of working mothers ought to be provided. While the author's personal views will be clear, an attempt is made to examine the provision of day care given the goals of each proposal, and given different standards for day care. I compute the costs involved that are assignable to day care in each case.

Section I examines the day care debate. It considers the different motives of those supporting a large expansion in organized day care, and then examines some of the justification for public support of day care. Section II looks at general difficulties encountered in the discussion of day care. What are the real costs of day care and just what quality levels of day care are being discussed? What general economic principles should be observed in any proposal? Section III examines each reform proposal in turn, and considers how day care might be integrated with each one. Should care be subsidized, and if so, how? What will various approaches cost and how might those costs be reduced? Section IV briefly looks at some of the other issues (discrimination, family size, horizontal equity), that might be of concern for public policy in day care. Section V considers how day care might be supplied and what forms public intervention in the industry might take.

I. THE ORIGINS OF THE DAY CARE DEBATE—RATIONALES FOR DAY CARE

The current policy dialog on day care calls for a major increase in extra-family day care. Yet, there are some real differences among the views of advocates of public involvement in day care. Those who favor day care to free mothers to work, want both to enable mothers to escape from welfare by working, and to insure that their children receive adequate care. Those who favor day care to help poor children want to reach them with particular services, such as medical care, food, and Head Start-type compensatory education that will help them later to break out of the cycle of poverty. And those who favor day care as early education want to reach all children with educational services earlier in life, regardless of family income, as the natural downward extension of the public school system. The last two groups view poor children as a separate clientele for welfare services that can help them escape from poverty, whatever their parents do.

This section will attempt to deal with these motives for day care, and will consider some of the theoretical reasons for public intervention into day care. The treatment is not meant to be exhaustive, but merely to point out some of the questions to be answered.

A. Motives for Day Care

1. *Custodial motives.*—Historically, the AFDC program was developed because it was felt that mothers were needed in the home to look after their children, and ought to be supported so that they could

remain there. There has been an increase, in the last few decades, of the labor force participation rate of women with children. This increase over time has led those making public policy to be less willing to justify keeping permanently at home all poor women with as few as one schoolchild, and discouraging those women from working. But it would seem strange to move directly from one extreme to the other, from paying mothers to stay home and discouraging work, to requiring them to leave home and work, and place their children in day care.

This paper will advocate a middle position which encourages work through low benefit-reduction ("tax") rates and by day-care deductibility. It is argued that any work requirement ought to be limited to certain types of families for whom day care is relatively inexpensive, for example those with no preschoolers and only a few schoolchildren.

I will emphasize that extra-family day care is a valid work-related expense, and thus, should be deductible. But then so is a hired housekeeper, and for similar reasons. It is felt strongly that good day care is extremely important. Making it nondeductible means in essence that if day-care expenses consume a sizable part of income and the parent faces a high marginal tax rate, then the parent may well lose by working. This probably would mean that poor and cheap care will be purchased. So, arguments about horizontal equity aside, we make day care deductible to encourage parents to purchase high quality care for their children.

2. *Affective motives*.—From the former general view in the child psychology profession that maternal deprivation was extremely dangerous, the position has evolved that extra-family child care, while also potentially dangerous for young children, can be useful in many cases. For neglected children in poor families, Government-sponsored day care can be invaluable. Yet, it would seem that it will cost a great deal to replace the care of most young children looked after by parents who are financially poor, but not mentally ill. This applies especially to young children (certainly those below age 3). It may make more economic sense to pay parents enough to be good child rearers, rather than to ask them to surrender the care of their children to others. It would seem that the burden rests on those favoring affective day care to show that children are made better off by being placed in high-quality, high-cost, developmental day care, rather than being left at home with parents *to whom are transferred* the resources that otherwise would be used in that day care.³ Parental love is hard to buy.

It may be felt that poor parents (especially in one-parent homes) are not suited to bring up children who will not be poor in turn. This would seem to fly in the face of much of our experience in this country besides raising some very explosive political issues.

3. *Cognitive motives*.—Poor children seem to start off behind rich ones when they enter grade one. There is a real debate as to what effect early educational intervention can have in raising their permanent performance. One view, the "critical period" thesis, would hold that intervention early enough can be permanently effective.

³ The argument is developed in depth, in William Shannon's article, in the *New York Times Magazine*, Apr. 30, 1972, entitled, "A Radical, Direct, Simple, Utopian Alternative to Day-Care Centers." For other treatments on the effect of maternal deprivation, see Steiner in *The State of Welfare*, or Sheila Coles in the Dec. 12, 1971, issue of the *New York Times Magazine*.

The other view, the "fadeout" effect, holds that such intervention can only result in a temporary spurt which fades out after a length of time. The debate recently has centered on Head Start, with unclear results. What may be needed is an increase in available resources for educating children all the way along. But we need not place children in child care for 10 hours a day to achieve our educational objectives. Achieving these objectives would not require extensive day care, but a wider use of subsidized nursery schools (full-year Head Start). But if we provide extensive day care from other motives, the opportunity could be used to deliver educational services to the poor at relatively lower cost.

Some precise idea of what can be achieved in early education is needed before it is made a major justification for day care. If parents are doing a poor job, we might seek to make them better parents rather than place their children in day care centers.

These rationales for day care, while not entirely contradictory, imply different types of child care. Custodial motives would favor standard day care; educational and affective motives a more extensive and more fully and generally subsidized form of care. On the other hand, if we accept one motive for day care, achieving the others becomes cheaper. If children are in nursery schools 3 or 4 hours a day, it would cost less to free mothers for the entire day.

There is a danger that the very poor will be used as "showcase" consumers, that limited resources will be used to purchase extremely good care for a small number of poor children, while the majority of poor and near-poor children with working parents remain in inadequate day care. This approach would fail to deal with the real problems posed by a system based on generally poor care for children.

B. Economic Rationales for Day Care

But why should the Government intervene economically in the provision of day care? Some traditional arguments suggest themselves, but most, while they point out inadequacies in the present setup, do not indicate a clear need for extensive day care as the only or best answer.

1. *External economies.*—It can be argued that the lack of good pre-school day care prevents a number of poor children from developing to their full potential, and that this makes society as a whole worse off. If antisocial behavior could be traced to inadequate early child care, there might be a strong argument for public intervention. But this intervention need not occur through heavy public support of day care. It might more efficiently come from raising the income levels of the parents.

2. *Capital market failure.*—The external economies argument seems somewhat stretched. The real problem is one of market failure, since the individuals who buy day care are not the ones who directly benefit from it. College students with access to the capital market can borrow further education against future earnings (or at least the Government now makes it possible for them to do so). Children have no such option. Parents make the decision for them, with the child's welfare as only one of many considerations; nor could the parent finance day care from the child's future income even if he wanted to. Nor can the adult in later years go back and spend money on early education for himself. In effect,

society alone can make that decision for the child. The parent's time horizon tends to be much shorter than society's.

3. *Horizontal equity: A failure of nonmarket institutions.*—Society is set up for two-parent families who take the responsibility for raising children. If one parent is absent, society must step in to correct this failure in its institutions and help to raise the child. Again both this argument and the previous one, even if we accept them, do not necessarily argue for day care. They might argue equally for supporting the single parent in the home and perhaps aiming programs like Head Start at the child. The real issue is noneconomic: What makes children into better adults and what makes them happier while they are children?

4. *Vertical equity.*—As part of income redistribution we often transfer specific goods to the poor. Why not support day care for them, enabling them to work outside the household and earn more? As we argue later, this may well be a very inefficient way to help either poor parents or their children, both of whom might be substantially better off receiving their help in another form.

5. *Merit wants and externalities of consumption.*—This argument states that work outside the family is a virtue in and of itself and ought to be encouraged. Those who work are better citizens. Work inside the household is not considered to be of such merit. This argument is partially normative, but to the extent that we all can agree on some definition of the term "better citizen," the argument ought to be empirically testable. If we do accept this argument, it calls for custodial care and views children largely as a hindrance to the goal of labor force participation.

On the other hand, labor force participation by parents may be seen as essential in helping the children develop positive attitudes toward work and teaching them to become productive workers. This would argue for tolerating possible present losses in the parents' working in order to help the children eventually to escape poverty.

6. *Women's rights.*—The current arrangements discriminate against women who are forced to take care of children, according to this argument. A larger supply of day care will enable women to choose rationally what kind of work (in the home or in the marketplace) best suits them. While this is a persuasive argument for allowing deduction of day-care expenses from income, it hardly argues for a subsidy of day care beyond that, which would skew the decision the other way and make the alternate care of children seem free. At issue here is the question of who is primarily responsible for child care, the parents who bear them or society at large? Is society to step in only when parents cannot fulfill their obligations, or should it remove those obligations altogether? The tendency to date has been very much against the latter view.

Most of the arguments in this section have ended up focussing on the issue of what effect preschool care of various qualities can have on children. Until we know exactly what an extra dollar of day care buys us (in terms of results), the discussion can remain at best an intuitive one, in which talk about externalities just points out our inability to measure the true results of widespread expansion of extra-family (out of the child's home) day care.

II. GENERAL DISCUSSION

As much as possible it is desirable to avoid programs that are economically inefficient. A program can be considered inefficient if another scheme would make everyone better off.⁴ In terms of income maintenance programs this is equivalent to stating that one program is inefficient if another program, with the same level of expenditures, can make some recipients better off and none worse off. For example, it would be inefficient to induce mothers to work and use State provided (or financed) day care if the present value of the extra production generated by their working were less than the cost of day care for their children.⁵

⁴ To be technically accurate, a program is inefficient if another scheme would make someone better off and no person worse off. But the somewhat less precise definition of pareto optimality in the text will do for all practical problems.

⁵ In evaluating the costs of not working this year as against working and using day care, the mother must consider more than the present year's salary as the cost of not working; she must also allow for future productivity gains caused by her present attachment to the labor force. Consider that her real wages in a given year may be represented by the series w_0, w_1, \dots, w_{30} where w_i is her wage in year i and she will work for 30 years after the present one. If she decides to remain out of the labor force for 1 year, the series is $w'_0, w'_1, w'_2, \dots, w'_{30}$, with $w'_0 = 0$. If r is her time rate of preference between a dollar of real wages in 1 year and a dollar of real wages in the next, then the present value of the cost of not working is

$$L = \sum_{i=1}^{30} \frac{w_i - w'_i}{(1+r)^i}.$$

Assuming that the year's layoff has not caused her productivity to actually decline, then

$$w'_i = w_{i-1} \text{ and } L = w_0 + \sum_{i=1}^{30} \frac{w_i - w_{i-1}}{(1+r)^i}.$$

If we further assume that $w_i = (1+a)w_{i-1}$, where $100a$ represents her percentage productivity increase over time, then we can easily show that

$$L = \frac{w_0 r}{r-a} \left[1 - \frac{a}{r} \left(\frac{1+a}{1+r} \right)^{30} \right]$$

for $a \neq r$. For $w_0 = 3,000$, some values are shown for L in the following table given different values of a and r .

		r			
a		.02	.03	.05	.08
.01	3,768	3,667	3,516	3,371	
.02	4,765	4,522	4,162	3,820	
.03	6,060	5,621	4,973	4,366	
.05	9,930	8,854	7,286	5,852	

It is easy to suggest that per year productivity gains for low skilled mothers would be quite small, and that their time rate of preference for current income is quite large (given their young families).

However, the losses in the table above will be much larger if sustained layoff seriously compromises the mother's employability. In the model developed, this appears as $w'_i = (1-b)w_{i-1}$, and we can show that now

$$L = \frac{w_0(r+b)}{r-a} \left[1 - \frac{a+b}{r+b} \left(\frac{1+a}{1+r} \right)^{30} \right].$$

Given a , r , and b , this raises L in value over the table above by

$$\frac{w_0 b}{r-a} \left[1 - \left(\frac{1+a}{1+b} \right)^{30} \right];$$

for $a = .01$, $r = .03$, and $b = .05$, L rises by 3,335 to 7,002, so that in this case the 5 percent fall in salary due to the layoff almost doubles the real loss.

By giving this money to the mother and allowing her to stay at home, the family receives more income and is better off, assuming of course that the children are not substantially better off in the day-care facility.^{6 7} If day care for a family is very expensive relative to the mother's potential productivity after training, it may even be optimal to delay training her until her children are somewhat older and the costs of caring for them during training are somewhat less. One potential danger when a mother is required to work in order to receive welfare support is that she may find it necessary to use very low cost and inferior quality day care if her earnings are low. Such an arrangement may endanger the development of her children and would represent a shortsighted approach to the problems of poverty.

Defining the Level of Day Care

Before we can evaluate the various child care programs and estimate their costs, it is necessary to decide exactly what type of day care we are considering, since the cost per child can vary substantially. The terms "minimum," "acceptable," "desirable," "custodial," and "developmental" are all used to describe day care. While it is clear that the projected costs of care will depend on who is setting the standard, the following criteria might be used. The term "standard care" will be used to define the level of care necessary to replace the care given to the child by a mother present in the home full time. Standard care should include the physical and supervisory care provided by the mother, but it also should include the emotional and developmental care available at home necessary to insure the child's proper development. The child should be neither better nor worse off under standard care than he would be at home, especially as concerns his mental and physical growth. With this approach, care beyond this level is treated as a deliberate transfer of resources to the child, and is not considered here an expense of child care incurred in order to free the mother to work. Even accepting this, some problems still remain, such as defining "the level of care necessary to replace the care given to the child by a mother present in the home full time." Even allowing for personal differences among parents with the same income, the fact remains that children in poor homes tend to receive a poor level of physical care,

⁶ While it may be true that some taxpayers are made to feel better off when welfare mothers are forced to work (external economies), we do not discuss this because it is not measurable, some taxpayers who value care for children by mothers may feel the reverse, and more importantly, because we suspect that opinions are not so easily vocalized by taxpayers. To consider such an effect, we would have to find taxpayers who would answer yes to the following question: "Would you agree to forcing welfare mothers to work if it did not lower your tax bill, and made the poor families involved worse off?" Taxpayers may now say that they favor forcing mothers to work because they feel that this would lower their taxes (and thus are indicating their preference for lower taxes).

⁷ We might also be concerned about possible bad effects on the children of having no adult in the family working. It may be that children learn how to participate in the labor market by observing their parents, or that they see work as a normal and important part of their lives only if they see adults around them working. In that case there would be a real gain in the long run in inducing the parent to work (even if it were very costly) so as to reduce the probability that the children will themselves require welfare.

because the money is just not available to purchase decent food, clothing, or shelter.⁸

One measure of care given to the child by a mother present in the home full time, might be the average care in homes just above the poverty line (or wherever the minimum income line is set), since in some sense we have determined that the physical quality of life among families below this income is inadequate. If we want to transfer additional resources to children, such transfers do not clearly depend on the mother's decision to work. We probably would want to reach all poor children with these extra resources, whether or not they are in full-time day care centers. For example, suppose it were decided that many later social problems could be avoided if poor children were provided with early preventive medical attention: we would not want to limit such care only to children in day care centers. Yet many of the high-cost day care proposals include a number of these social programs in their costs. This leads to a position where incentives might well be perverse: an extremely low productivity mother might volunteer for work although her wage nowhere near pays for standard care for her children, so that the children might qualify for the educational, medical, and nutritional services available through the day care centers; this clearly would be economically inefficient.⁹ And quite aside from incentives, these are services that, if they are judged important for poor children, should be delivered to them whatever the mothers' decisions on work.

The definition of standard care has analytical significance for comparing one situation in which a mother stays home and receives welfare with another in which she goes to work and uses day care. Usually the comparison involves evaluating three variables: the change in the mother's welfare (usually "Does she have a larger spendable income when she works?" since she may not enjoy working, especially if she is required to do so); the change in the total Government expenditure on the family; and the change in the welfare of the child. Using the concept of standard care we would assume that the child is as well off in either case. This limits the discussion to the other two variables, both of which can be stated more easily in monetary terms.

The Cost of Standard Care

Much of the past information regarding the cost of child care has been confusing. In this section I shall attempt to identify exactly what items are to be included. But the cost per child still will depend on the critical staff-to-child ratio. Between 75 and 80 percent of day care center costs are in salaries, so the costs of standard care will depend on what staff level fulfills our criterion of replacing the mother's care. In the numbers developed here, a range will be given for standard care, with the staff-to-child ratios identified at each end. Calculations

⁸ The poor mother forced to work by inadequate public income, who places her children in low-cost, low-quality day care is not abusing them. Rather, she is deciding that the level of physical care she can give them, while not earning money, is so low as to make them better off in bad day care with enough additional income for food and shelter, than they would be either with her or in high quality day care that costs too much.

⁹ This prospective inefficiency can be somewhat reduced, or even eliminated, if the costs of providing special services that we intend to deliver to poor children, once they are in day care, is substantially lower than the costs of providing those services to the children if they remain at home.

throughout the paper are done for both ends of the range. It is then for the reader to decide just what costs best suit our notion for standard care. While the author favors the upper end and later will support this bias, there is room for disagreement. Most experts would agree that poor day care can damage a child's development, but the gradations from poor to adequate and above are difficult to determine objectively. Just what "adequate" day care means is unclear. The debate over the evaluation of Head Start indicates how difficult it is to show that a developmental program is essential for a child's welfare.

The costs of standard care here are based on the per child cost estimates published by HEW in 1968 for 1967 costs. A new set of standards recently has been costed but has not yet been made public. Tables 1 and 2 reproduce two of the cost tables. One is for children between the ages of 3 and 5 in a day care center for a full day and the other for children of school age (up to 14) cared for before and after school and during the summer. Costs are provided for three different qualities of day care in each case: "minimum," defined as "the level essential to maintain the health and safety of the child, but with relatively little attention to his developmental needs;" "acceptable," defined as "to include a basic program of developmental activities as well as providing minimum custodial care;" and "desirable," defined as "to include the full range of general and specialized developmental activities suitable to *individualized* development."¹⁰

In the notes to the figures, the report states:

Individual experts will differ as to the elements required for each level of quality. Most experts feel that the disadvantages to children of a "minimum" level program far outweigh the advantages of having the mother work. Some will feel that for children from "disadvantaged" homes only the "desirable" level is appropriate. The figures shown represent a consensus among a number of experts of what would be required at each level of quality.

¹⁰ Department of Health, Education, and Welfare, Office of Child Development, *Standards and Costs for Day Care* (1967).

TABLE 1.—*HEW day-care estimates—description and annual cost per child ("cost") pre-school children (3 to 5) standards and costs for a full day in a center*

Program element	Minimum		Acceptable		Desirable	
	Description	Cost	Description	Cost	Description	Cost
1. Food (meals and snacks)-----	1 meal, snacks-----	\$140	2 meals, snacks-----	\$210	2 meals, snacks-----	\$210
2. Transportation-----	By parents-----	0	By center-----	60	By center-----	60
3. Medical and dental-----	Examinations and referral.	20	Examinations and referral.	20	Examinations and treatment.	60
4. Work with Parents-----	Little or none except problem cases.	10	General activities and limited counseling.	30	Parent education and full counseling.	70
5. Facilities and Utilities (rental)---	State requirements----	90	State requirements----	90	More generous-----	110
6. Clothing, other emergency needs---	As necessary-----	20	As necessary-----	20	As necessary-----	20
7. Supplies and materials-----	Custodial program	40	General developmental program.	50	Individualized developmental program.	75
8. Equipment (replacement costs)-----	do-----	10	do-----	12	do-----	15
9. Staff:						
(a) Classroom professional (at \$6,600).	1 per 20 children-----	275	1 per 15 children-----	405	1 per 15 children-----	405
(b) Classroom nonprofessional (at \$4,400).	2 per 20 children-----	320	2 per 15 children-----	420	3 per 15 children-----	640
(c) Social service professional (at \$6,600).	1 per 150 children-----	65	1 per 100 children-----	65	1 per 100 children-----	65
(d) Community, parent, health aides (\$4,400).	None-----	0	do-----	20	2 per 100 children-----	45
(e) Business and maintenance (at \$4,400).	2 per 100 children-----	80	3 per 100 children-----	120	3 per 100 children-----	120
(f) Special resource personnel (at \$6,600).	Urgent need only-----	20	1 per 100 children-----	60	2 per 100 children-----	120
(g) Supervision (at \$8,000)---	1 per 100 children-----	80	2 per 100 children-----	160	do-----	160
10. Training-----	10 percent of salaries---	75	10 percent of salaries---	120	10 percent of salaries---	145
Total per child-----		1, 245			1, 862	2, 320

TABLE 2.—*IEW day care estimates, school-age children—before and after school and summer care*

Program element	Minimum		Acceptable		Desirable	
	Description	Cost	Description	Cost	Description	Cost
A. SCHOOL YEAR (40 WEEKS)						
1. Food (meals and snacks)-----	Snack-----	\$30	Snack and breakfast----	\$70	Snack and breakfast----	\$70
2. Work with parents-----	Urgent only-----	10	Supplementary to school services.	20	Supplementary to school services.	20
3. Facilities-----	School, other no rent----	10	Same-----	10	Same-----	10
4. Supplies and materials-----	Custodial-----	20	Developmental-----	40	Developmental-----	40
5. Equipment (replacement cost)-----	do-----	10	do-----	15	do-----	15
6. Personnel:						
(a) Day care workers (at \$4,400) -	1 per 25 children for 3 hours.	53	1 per 15 children for 3 hours.	88	1 per 15 children for 3 hours.	88
(b) Special Resource Personnel (at \$6,600).	None-----	0	1 per 45 children-----	66	1 per 45 children-----	66
(c) Business (at \$4,000)-----	1 per 250 children-----	12	1 per 250 children-----	12	1 per 250 children-----	12
(d) Supervision (at \$8,000)-----	do-----	24	2 per 250 children-----	24	2 per 250 children-----	24
7. Training-----		9		28		28
B. SUMMER PERIOD (12 WEEKS)						
1. Food (meals and snacks)-----	1 meal, snacks-----	35	2 meals, snacks-----	50	2 meals, snacks-----	50
2. Work with parents-----	Urgent only-----	5	Supplementary to school services.	15	Supplementary to school services.	15
3. Facilities-----	School, other no rent----	20	Same-----	20	Same-----	20
4. Supplies and materials-----	Custodial-----	10	Developmental-----	15	Developmental-----	15
5. Equipment (Replacement cost)-----	do-----	5	do-----	10	do-----	10
6. Personnel:						
(a) Recreation supervisors (at \$4,400).	1 per 25 children for 8 hours.	40	1 per 15 children for 8 hours.	65	1 per 15 children for 8 hours.	65
(b) Special resource personnel (at \$6,600).	None-----	0	1 per 30 children-----	55	1 per 30 children-----	55
(c) Business (at \$4,000)-----	1 per 250 children-----	4	1 per 250 children-----	4	1 per 250 children-----	4
(d) Supervision (at \$8,000)-----	do-----	8	3 per 250 children-----	24	3 per 250 children-----	24
7. Training-----	10 percent of salaries-----	5	15 percent of salaries-----	22	15 percent of salaries-----	22
Total per child-----		310		653		653

The HEW numbers do not appear to be out of line with those of other studies done recently of the costs of quality day care (although of course they may have been influenced by the earlier HEW results.) Mary Rowe examines some of these other studies and finds their cost estimates are compatible with those of HEW.¹¹

In refining HEW's cost to yield those of standard care, an attempt is made to exclude those items in the HEW estimates that do not replace services rendered *directly* by the parent, but instead replace items normally *purchased* by the parent for the child, as well as extra services not necessarily bought by the parent but deemed necessary for poor children by public policy (for example, preventive medical and dental care). Transportation costs must be included in the cost of standard care because they are real costs incurred by the working parent whose child must be brought to the center. Day care staff are counted as they replace the mothers' services. Food is harder to break down, however. Some of the costs replace those normally incurred by the parent (the child must be fed at home, too); some of the costs are for preparation, a service rendered directly by the parent; and some of the costs in the higher estimates are for more food. (The minimum provides one meal and two snacks; other provide two meals and two snacks.) In the estimates of standard care here, the cost of food in the "minimum" HEW estimate is used as a compromise. Although some food costs might be counted as a normal out-of-pocket cost to parents, preparation would have been provided directly. Thus, minimum food costs appear in the total.¹²

In an industry like day care, a fairly regular staff turnover might be expected. At least some of the training costs must be seen as ongoing and normal costs of doing business (as they are in private industry). Some of the work with parents and social service are essential for day care since they help the parent adjust to not seeing the child for nearly three-quarters of its waking hours. We should not be surprised that some coordination costs result from splitting child care between two entirely different agents. And special resource personnel (computed as 1 for 300 children for "minimum" care and 1 for 100 children for "acceptable" care), may be needed to compensate for having an unusually large number of children in one place.

Using the figures for "acceptable" care in table 1, if we subtract from "acceptable" care costs (\$1,862) the extra costs for better food, all medical and dental expenses, and half the training costs, costs can

¹¹ U.S. Congress, Senate Committee on Finance, Mary P. Rowe, "The Economics of Child Care," hearings on S. 2003, Child Care Provisions of H.R. 1 and title VI of printed amendment 318 to H.R. 1, 92d Cong., 1st sess., Sept. 22, 23, 24, 1971 (Washington, D.C.: Government Printing Office, 1971), pp. 235-313.

See especially pp. 272-292. She examines estimates done by Abt Associates, Inc., and the Westinghouse Learning Corp. (see below), and finds that by adjusting for differences in data and how they treat imputations, part-time attendance, interest, startup costs, etc., the numbers can be shown to be rather similar.

Abt Associates, Inc., *A Study in Child Care 1970-71* (OEO contract No. OEO-BOO-5213), 55 Wheeler Street, Cambridge, Mass., April 1971, and Westinghouse Learning Corp. (Westat Research), *Day Care Survey 1970* (OEO contract No. 800-5160), Apr. 36, 1971.

¹² This discussion focusses on the accounting problem of what costs to allocate to "standard" day care; that is, what costs go to replace the actual services given to the child by the mother? Of course it is likely that any day care program for the poor would involve a subsidy for food, although we also would likely require the poor to bear some of the food costs (perhaps by a reduction in the guarantee level).

be reduced by \$150. But it is difficult to cut much more without reducing the level of what is defined as "acceptable" care (to include "a basic program of developmental activities as well as providing minimum custodial care") below what we have defined as standard. This produces a figure of \$1,710 (\$1,860 minus \$150).

However, some people would feel that this cost is very high for our definition of standard day care and that much more could be cut. In a recent report (1971), Dr. Blanche Bernstein and Priscilla Giacchino¹³ claim that "using HEW standards for cost, about 40 percent of the operating budget of a day care center providing acceptable care can, at a conservative estimate, be ascribed to education, special services, and training." Examining the HEW costs for preschool full-time day care in table 1, "acceptable" care cost \$1,862 per child per year in 1967. Subtracting 40 percent reduces this to \$1,117, which is \$132 below the cost of HEW "minimum" care. This is not surprising, since the 40 percent figure assumed removing all costs related to training, medical and dental services, work with parents, social service, special resources personnel, and parent and community aides, as well as the cost of one classroom professional. This looks very much like what HEW calls "minimum" care. From the HEW figures for minimum care, subtract all medical costs, parental work, social service, aides, resource personnel, and training, and add back in the transportation omitted by HEW in this estimate. This reduces the HEW total by \$130. So the Bernstein number resembles the cost of stripped minimum care. I judge the level of this care to be unacceptably low for standard care. Lacking hard evidence, my preference is for "acceptable" care which seems to resemble more closely the care hopefully provided by a parent in the home full time.

We are now able to establish a range for the cost of standard care between the Bernstein number and the higher figure for "acceptable" care: \$1,120 to \$1,710, with the bias of this paper toward the higher number. "Minimum" care already has a ratio of 3:20 for staff in direct contact with the child, or more exactly 1:6% (or 6% omitting social service staff). The staff-to-child ratio of "acceptable" care is 1:4% (or 4%). By contrast, the recent recommendation reported by the Senate Finance Committee requires only one adult for up to eight preschool children, or two for up to 15,¹⁴ well outside this range. The results are summarized in table 3.

TABLE 3.—*Estimates for standard day care for 1 child between the ages of 3 and 5*

	1967 prices	Add 20 percent inflation	Add 30 percent inflation
Minimum (Bernstein)-----	\$1, 120	\$1, 344	\$1, 456
Maximum (acceptable)-----	1, 710	2, 052	2, 223
Amount included for food in the above 2 estimates-----	140	168	821

¹³ B. Bernstein and P. Giacchino, "Costs of Day Care: Implications for Public Policy," *City Almanac*, a bulletin of the Metropolitan Information Service (August 1971), p. 12.

¹⁴ Department of Health, Education, and Welfare, "Proposed Revised Federal Day Care Requirements," in *Additional Material Related to Child Care Legislation*, Committee on Finance, U.S. Senate (Washington D.C.: Government Printing Office, 1971), p. 41.

It is necessary to correct for inflation over the past 6 years (up to 1973). Using inflation of 20 percent the range of day care costs becomes \$1,344 to \$2,052. Taking the top estimate of \$2,052, standard day care would cost about \$40 per child per week. The lower estimate is still over \$26 per child per week. Yet in a Massachusetts early education project study,¹⁵ only 9 percent of all mothers (all incomes), said that they would be able to pay over \$20 for child care of their choice for one child under 6 years old. Mary Rowe states: "In general, families earning less than median incomes do not, and say they cannot, pay more than \$6-\$12 per week per child."¹⁶ This may represent in part the inevitable result of poverty—families in which the mother's income is essential for subsistence cannot afford to spend a large part of that income on child care. Families in which the mother's earned income is not essential may be stating a choice against paying over 30 percent of the mother's gross earnings for child care, given taxes. How we treat day care expenses for the poor (vis-a-vis deductibility and subsidy, discussed in part III), will radically affect what type of day care the mother can purchase. To many current recipients of AFDC, a certain amount of day care is free, since they can deduct its cost from their incomes before benefits are computed.¹⁷

The Real Cost of Working to Mothers and Society

Despite some early economies of scale in child care, the real cost of extra-family day care is high relative to most women's earnings. Although one mother is needed to care for one child in the home, substantially fewer than four mothers are needed to care for four children in a center. However, this is largely because caring for a child in the home does not require full-time work, just full-time availability. While she is watching over her child (giving him child care), a mother can at the same time cook, clean house, wash dishes and clothes, shop, and so forth. Seen as a whole, these are the "joint outputs" of housework. For the price, or work, of one, you get both child care and housework.

Thus, when a mother arranges for day care for her child and goes out to work, she also loses all those other outputs and still must find a way to shop, clean, cook, and wash. Little wonder that a mother not in desperate need of income is reluctant to pay a substantial part of her wage for child care. Working involves substantial costs beyond the loss of child care. Her reluctance increases if the mother enjoys taking care of her children, if she dislikes the type of work she is offered (which is likely when it is low-skill, low-productivity work),

¹⁵ Cited in Mary P. Rowe, loc. cit., p. 7.

¹⁶ Ibid., p. 6.

¹⁷ For women just above the poverty line, current tax law in 1971 allowed the deduction of \$600 for day care for one child, \$900 for two or more. For a married woman, family income must be below \$6,000, and the limit is reduced \$1 for every \$1 of income above \$6,000. The Child Services Act of 1971, S. 2003, would raise the limits for the deduction to \$1,000 and \$1,500, respectively, and would raise the income ceiling to \$10,000. Above \$10,000, the allowable deduction would fall 50 cents for every \$1 raise in income. See U.S. Congress, Senate Committee on Finance, *Material Related to Child Care Legislation* (Washington D.C.: Government Printing Office, 1971), p. 18. Recent tax legislation has substantially liberalized day care deductibility for married women.

and if she distrusts (or has some uncertainty about) the child care she is buying.¹⁸

What a mother does at home is generally not considered "production." It is not imputed and added into calculations of the gross national product. But ignoring it leads to the conviction that a major gain in efficiency is possible by putting welfare mothers to work. It is thought that if two mothers have two youngsters each, we ought to be able to assign the child care to one, put the other mother to work, and come out ahead. Yet given the value of the other things a mother does during the day, the costs of transportation to and from day care and work, the unpleasantness and low pay of low-skill work, and the risks and loss of pleasure in having one's children raised by others, the gain is not at all clear.

Work for women with preschoolers is a clear gain only when low-cost, reliable day care is easily available or when the mother is extremely productive in a marketable job, a situation that usually is found among well-educated women, who in general are not poor. Among middle-class families, a working mother generally pays for the heavy housework as well as for child care.

Work is also more clearly a gain when the children are not present most of the day (when they are of school age); during school hours the mother no longer produces child care as she works in the home, so that the cost of going to work is reduced. The 1968 HEW figures for child care are dramatically lower for part-time care before and after school and in the summer—only \$310 annually for "minimum" care and \$653 for "acceptable" or "desirable" care (table 2). Using available school buildings, of course, saves the cost of rent for day care. But the real cost reductions result from the sizable drop in supervision needed. Older children need substantially less supervision than pre-school children, and during the school year that supervision is needed for only 3 hours per day. Food becomes a more important component in the cost: \$65 for "minimum" care and \$120 for "acceptable" care. Salaries account for 57.5 percent ("minimum") or 65.5 percent ("acceptable") of what remains. The costs may be somewhat higher for younger schoolchildren and lower for older ones. Using a notion of standard care is somewhat more difficult here, but in 1967 parents would have faced costs of between \$310 and \$598 for a complete year per child. Inflation at 20 percent brings this to \$372 and \$718. And these figures include food, which parents would have to purchase in any case. Work would appear more attractive to such families, although if there are more than four such children in a family, part-time work during school hours might be more attractive. The results for standard care are summarized in table 4.

¹⁸ For a sophisticated treatment of labor market participation by married women, see Glen G. Cain, *Married Women in the Labor Force; An Economic Analysis* (Chicago: University of Chicago Press, 1966).

TABLE 4.—*Estimates for standard day care for 1 child between the ages of 6 and 14*

	1967 prices	Add 20 percent inflation	Add 30 percent inflation
Minimum-----	\$310	\$372. 00	\$403. 00
Maximum-----	598	717. 60	778. 40
Amount included for food in the above 2 estimates-----	65	78. 00	82. 00

It would seem then that requiring welfare mothers to work is inefficient when the cost of day care begins to approach the value of their work outside the home (see the earlier discussion), since they also lose the value of their own housekeeping services. The non-monetary nature of all work within the household causes its potential loss to be ignored while the wages earned by the mother are tangible and thus more clearly seen as pure gain. The higher the costs of "standard day care," the less likely any working parent is to use it unless it is heavily subsidized.

In computing costs for day care it is dangerous to simply project the day care expenses of those now on welfare and working. Currently, many families are able to lower their day care costs substantially by placing their children in the care of relatives, either in the relative's home or in their own.¹⁹ This enables them to obtain generally reliable and personal care for their children for very low cost. In such cases, the mother might be considered part of a larger family and her decision to work made as it would be in normal two-parent families. However, it would be misleading to assume that as large a proportion of welfare mothers not now working would be in that situation were they required to work. We might expect that a larger proportion of poor mothers in one-parent families who have the opportunity of getting relatives to care for their children are now working than of those without such opportunities. Most welfare mothers who do not work now report that they lack cheap, reliable day care. Of course the current disincentives to work resulting from the treatment of earnings under income-related programs also influence them.

III. INTEGRATING DAY CARE WITH WELFARE

The three plans can be examined separately, although we shall spend more time on H.R. 1 because in its context day care becomes most complex. In some sense, both a demogrant and H.R. 1 are negative income taxes, since both involve a basic guarantee level and a positive marginal tax on all earnings. The most important consideration as far as day care is concerned is the work requirement. Where it exists, our concern for the welfare of children implies a special concern for the arrangements that will be made for day care. Without a work requirement we may rely somewhat more on parents to forgo work if they cannot make adequate day care arrangements. Of course, even without a formal work requirement, a low basic guarantee level

¹⁹ See sec. III, alternative 2, for a more detailed breakdown of current care.

will induce women who might not work at a higher guarantee to enter the labor market.

One of the problems in any cost estimate is that we do not know how mothers will react to a given scheme of incentives. Since work is required in some of the plans, we can identify at least partially who will be working. But the day care arrangements which will result may be harder to estimate.

The Issue of Deductibility and Study

Before examining the three alternatives in detail, it will be useful to consider just how the day care expenses of those receiving welfare can be treated. The discussion of deductibility and subsidy will focus on a negative income tax with a positive implicit tax rate on earned income (With the Senate Finance Committee's workfare proposal, which involves a negative marginal tax rate,²⁰ the issue of deductibility is meaningless.)

Consider a negative income tax scheme with a marginal tax rate of two-thirds (which is the H.R. 1 rate). Allowing the deduction of day care expenses implies that for each extra dollar spent on day care (up to the limit of deductibility), the Government pays \$0.67 more in benefits to the family. Families with low incomes and high day care expenses could be allowed to deduct more than 100 percent of their day care expenses: a deduction of 150 percent of day care at the two-thirds tax rate would permit the Government to absorb fully each extra dollar spent on day care. Or we could choose a percentage in between, for example, a 125 percent deduction. This is exactly equivalent to the following arrangement: for given day care expenses and income, the Government pays directly for a certain part of day care; the rest is paid for by the family and is deductible.²¹

²⁰ See the later discussion of alternative 2.

²¹ This may be seen analytically. Imagine a family with a guarantee level of \$2,800 and an income disregard of \$720 (H.R. 1 applied to a family of five). Say the family uses child care costing C of which the Government directly pays a fraction a . The family thus pays $(1-a)C$ for child care. If there is no limit on child care deductibility (although there would be a limit in H.R. 1), then the benefit level becomes (where earnings are W)

$$B = \$2,800 - \frac{2}{3}[W - \$720 - (1-a)C] \quad (1)$$

and the total family income after taxes (benefits) and day care is

$$Y^d = W - (1-a)C + \$2,800 - \frac{2}{3}[W - \$720 - (1-a)C] \quad (2)$$

which can also be written as

$$Y^d = \$3,280 + \frac{1}{3}W - \frac{1}{3}(1-a)C \quad (3)$$

This is exactly equivalent to allowing this family to deduct $100+50a$ percent of day care after paying for all of it (clearly $100+50a$ lies between 100 and 150 for a between 0 and 1). To see this, we may rewrite the expression for family income after benefits and day care as

$$Y^d = W - C + \$2,800 - \frac{2}{3}[W - \$720 - (1+a/2)C] \quad (4)$$

When simplified, this expression becomes exactly the same as (3).

Two questions arise with respect to such a subsidy. First, how will the size of the subsidy fall as income rises (given a fixed total day care cost)? The faster the subsidy falls, the less its overall cost will be and the greater its effect in increasing the marginal tax rate on earnings. One dollar more in earnings not only reduces income supplement benefits by \$0.67, but also reduces the day care subsidy. This is a serious consideration with the income supplement tax rate already at two-thirds.²²

Secondly, how will the subsidy increase with the cost of day care to a family with a given income? Assuming that the Government will set a limit on its subsidy, *which* dollars of day care are to be subsidized? The Government might determine that it wants no family of earned income W to have to pay more than $f(W)$ —some amount dependent on W —for standard day care. Thus, a man who pays C_s to purchase standard day care (and for whom $f(W)$ is less than C_s) will receive a direct Government subsidy of $C_s - f(W)$. In that case, $f(W)$ will be the household spending for day care and will be deductible. Note that the effective marginal tax rate discussed above will be influenced by how $f(W)$ is set. The government can then subsidize the last dollars of care, either by allowing anyone who spends more than $f(W)$ to claim the difference as a tax credit, or by providing standard care for the price of $f(W)$. These methods, while they definitely encourage parents to purchase quality day care, also provide a very minimal incentive to economize by using whatever low cost reliable care is available. On the other hand, the Government can subsidize the first dollars of care, by crediting (toward higher benefits) the first $C_s - f(W)$ dollars spent, where C_s is the cost of standard care. Thus, the Government would pay for all day care costs up to $C_s - f(W)$, and the parents would pay for any additional costs beyond that amount. This is an awkward system. It provides no incentive to economize on day-care expenditures up to $C_s - f(W)$, the marginal cost to the parent of an additional \$1 of day care being zero, and no incentive to improve the child's day care arrangements beyond $C_s - f(W)$, the marginal cost being 1. To those parents already spending more than $C_s - f(W)$ on care, it amounts to a flat grant. Finally, the government might choose to subsidize a part of each dollar spent on care, say by crediting a fraction $\frac{C_s - f(W)}{C_s}$ of every dollar up to C_s spent on care. This reduces (as against no subsidy) the marginal cost of every dollar of day care to the parent, but still maintains some incentive to keep the cost of day care below the cost of standard care. Obviously many other subsidy schemes are possible.

²² This may be seen analytically by partially differentiating expression (3) in footnote 21 with respect to W :

$$\frac{\partial Y^d}{\partial W} = \frac{1}{3} + \frac{1}{3}C \frac{\partial a}{\partial W} \quad (5)$$

where $\frac{\partial a}{\partial W} < 0$.

The marginal tax rate is thus:

$$t_e = \frac{2}{3} - \frac{1}{3}C \frac{\partial a}{\partial W} \quad (6)$$

Our results discussed above are summarized algebraically in table 5. In the special case where the declared taxable income is negative but earned income exceeds the disregard,²³ the benefit is increased over the guarantee level by the marginal tax rate multiplied by the taxable income. This may not be permitted however. If earned income is less than the disregard, then the increase over the guarantee level is the tax rate multiplied by any day care expenses. The symbols used are specified in table 5. The amounts under H.R. 1 for a family of five are indicated in brackets.²⁴ The derivations are shown in supplement 1. It is assumed that income exceeds the disregard: for the case where this is not so, a new table is given in supplement 2.

Some actual figures for income after day care expenses and net benefits are presented in tables in supplement 3, with the different effective tax rates and effective marginal day care costs shown. We arbitrarily choose $f(W)=0.6W$. The choice of $f(W)$ determines exactly who the day care subsidy reaches and what the various incentives will be. If standard care costs \$3,000, then $f(W)$ will extend the subsidy to some people (depending on which scheme is adopted) earning \$5,000. If $f(W)=0.3W$, then the subsidy will reach families earning \$10,000.

Now examine table 5 (or suppl. 3). If working women cannot deduct their day care expenses, they will frequently end up with less than the minimum guarantee level, even when their wages more than cover day care. In our example (a family of five under H.R. 1 with a tax rate of two-thirds), if care costs \$3,000, the mother must earn more than \$7,560 before her disposable income (after day care is paid for) again tops \$2,800. Besides encouraging low quality care, this situation seems unfair.²⁵ The other schemes provide that the mother will not lose as long as she can cover day care out of her earnings.²⁶ But when some form of subsidy is being offered (say to protect the woman who cannot cover the cost of care), then it is the Government who may lose when she works. This can be seen clearly by noting that, if we imagine the mother paying for day care, with the subsidy and deduction rebate being paid as part of her benefit, then

$$Yd = G + W - C \quad (7)$$

²³ The disregard refers to those initial earnings which are not considered—"disregarded"—in computing total benefits. In H.R. 1 the disregard is \$720. Thus, a man who earns \$2,000 is taxed the implicit rate of two-thirds only on \$1,280.

²⁴ This family has a guarantee level of \$2,800 and a disregard of \$720. In addition, under H.R. 1 there would be a limit on the deductibility of day care of \$2,200.

²⁵ It is felt by some that the other schemes are very expensive, since the Government would essentially pay for a major part of the costs of day care. In the case of simple deductibility, the Government's share would be equal to t (here two-thirds). This characterization is somewhat misleading. In comparison with a system not allowing this deductibility, the Government costs indeed rise by two-thirds of the day care used. Yet in comparison with a system in which the mother does not work and receives the guarantee, the Government also saves on the welfare payment. We might better characterize deductibility as follows. The mother pays for all of day care herself out of her earnings. What is left is then used to compute the supplement. This more properly pictures day care as a work expense, not as consumption.

²⁶ This loss if she cannot cover day care out of her earnings is only again in comparison with a system in which she stays at home and receives the minimum guarantee. In States where the current welfare levels are very low, she will be better off under H.R. 1 regardless of how we treat day care expenses.

TABLE 5.—Day care, Government costs, family income, and the tax rate

	Y^d	TC_s	t_e	MC_s
1. No work-----	G	G	-----	-----
2. Work, no deduction for day care---	$G+tD+W(1-t)-C$	$G-t(W-D)$	t	1
3. Work, deduction limited to C_s (C_s could be C_s).	$G+tD+(1-t)(W-C)$ for $C \leq C_s$ $G+tD+(1-t)W-(C-tC_s)$ for $C > C_s$	$G-t(W-D-C)$ $G-t(W-D-C_s)$	t t	$1-t$ 1
4. Work, full subsidy on first $C_s-f(W)$ dollars, $C-[C_s-f(W)]$ deductible.	$G+tD+(1-t)W$ for $C_s-C \geq f(W)$ $G+tD+(1-t)\{W-[C-(C_s-f(W))]\}$ for $C_s \geq f(W) > C_s-C$ $G+tD+(1-t)(W-C)$ for $f(W) \geq C_s$	$G-t(W-D)+C$ $G-t(W-D-C)+(1-t)[C_s-f(W)]$ $G-t(W-D-C)$	t $t+f'-tf'$ t	0 $1-t$ $1-t$
5. Work, full subsidy on last dollars first dollars deductible.	$G+tD(1-t)[W-f(W)]$ for $f(W) \leq C$ $G+tD+(1-t)(W-C)$ for $f(W) > C$	$G-t(W-D)+C$ $-(1-t)f(W)$ $G-t(W-D-C)$	$t+f'-tf'$ t	0 $1-t$
6. Work, proportional subsidy up to C_s , payments by family deductible.	$G+tD+(1-t)\left[W-\frac{f(W)}{C_s}C\right]$ for $f(W) \leq C_s$ $G+tD+(1-t)(W-C)$ for $f(W) > C_s$	$G-t(W-D)+C$ $C\left[1-\frac{(1-t)f(W)}{C_s}\right]$ $G-t(W-D-C)$	$t+(1-t)\frac{f(W)}{C_s}$ t	$(1-t)\frac{f(W)}{C_s}$ $1-t$

Y^d =Parent's net income after paying day care and receiving net benefits; TC_s =Total cost to government including day care and net benefits; t_e =Effective marginal tax rate ($1-t$ the increase in Y^d given a \$1 increase in W); MC_s =The marginal cost to the parents of using \$1 more worth of day care; G =Guarantee level (2,800); D =Disregard (720); t =tax rate or benefit reduction rate ($\frac{2}{3}$); C_s =cost of standard care (2,460 to 4,205); C =cost of day care used; W =family earnings, assumed more than D ; $f(W)$ =maximum payment for standard day care.

The formulas that appear above are derived in supplement 1. If the government allows no deduction of day care beyond C_s , then each extra dollar of care beyond C_s will drop income by \$1; if deduction is allowed, then that dollar will drop income only $1-t$; any subsidy tied to income will further drop that cost, and also will extend the increase of the effective tax rate to higher incomes.

where Y^a is her disposable income after benefits and day care and G is the total cost to the Government. In a situation where the mother stays home, $Y^a = G_o$ = minimum guarantee, and W and C are zero; if, when she goes to work, the Government wants to make sure that Y^a does not fall, then G must rise if $W - C$ is less than zero (that is, if her earnings do not cover the cost of care). If the Government does not let G rise, then the mother is forced to face the choice discussed earlier: inadequate income, or poor care.²⁷

Alternative 1: H.R. 1 as Passed by the House of Representatives

It is useful to examine first the provisions of H.R. 1 regarding child care.²⁸ Female heads of households in which there are no children under 3 years of age are required to register for job training and work. This requirement does not apply to mothers whose husbands are registered under H.R. 1.²⁹ Failure to register by the head of the family would reduce the welfare payments by \$800, so that most people required to register probably would do so. During training, child care would be provided. After training the working mother would be expected to pay for child care if her earnings are sufficient, but would be allowed to deduct its cost from her earnings before calculating her welfare benefits (subject to certain limitations on the size of the deduction). In the first year, \$750 million is assigned to child care, \$50 million of that to fund the creation of new facilities; the remaining \$700 million is expected to provide 875,000 child care slots, 291,000 of them for pre-school children.

FIRST YEAR TRAINING COSTS

It is important to understand that this \$700 million does not include the costs of deductibility of day care expenses, but is rather the explicit cost of providing those day care slots to parents taking training in the first year (for whom the full cost of day care must be borne). It implicitly assumes that those parents now working will not require new day care slots but only (perhaps) financing through deductibility and/or subsidy. While we will temporarily accept this assumption, it should be noted that a generous subsidy scheme for day care may well induce parents now working and using informal and poor day care to demand new and better facilities. Any scheme that does not allow parents now working to receive additional subsidies for upgrading their current level of child care involves serious questions of equity. If the goal of the program is

²⁷ In the example developed in supp. 3, if we set $C = \$2,400$, then the Government will pay out more than the guarantee unless the mother earns more than \$2,920 in case 2 (\$3,120 with no limit on the size of the deduction). In the subsidy cases, this breakeven amount will be \$3,554 in case 3, \$3,323 in case 4, and \$3,484 in case 5 (case 5 is proportional subsidy).

²⁸ U.S. Congress, Committee on Ways and Means, *Social Security Amendments of 1971*. H. Rept. 92-231, Government Printing Office (Washington, D.C.: 1971). See especially pp. 158-172.

²⁹ This provision seems highly arbitrary. If the desire of H.R. 1 is to ask adults who receive welfare to show some work effort, then it would seem that two-parent families are as able to supply two workers as one-parent families are to supply one. In fact, one would suspect that a child with two parents in the home is emotionally better prepared for day care than the child with one parent, and that the parent in a one-parent home already bears a much larger burden than the individual parents in the two-parent home with the same number of children.

to induce parents to work, while providing good day care for their children, we certainly should not discriminate against those who are already working, especially if their current day care arrangements are inadequate. In any case, while the Ways and Means Committee expects that 875,000 slots represent the maximum expansion in supply possible in 1 year, it expects further expansion later. The explicit cost will depend on how soon the mothers begin work.

First consider the \$700 million allotted for day care. How far will it go? Using the estimated costs for standard care, it is possible to calculate how much the 875,000 day care slots will cost. The results are summarized in tables 6 and 7. Including food (in the amount allotted in the "minimum" HEW figures), those day care slots can be delivered at a cost of between \$1,016 and \$1,101 million (depending on inflation) based on the upper estimate for standard care (favored by this paper). The range drops to between \$608 and \$659 million if the lower estimates of costs for standard care are used. In justifying the correction for inflation, note that day care as an industry is dominated by wage costs and subject to few productivity gains. In the last 5 years, wage costs have actually risen 35 percent, an annual rate of 6.2 percent,³⁰ so using 20 percent for inflation would be extremely conservative. Using the middle of 1967 as a base, the Bureau of Labor Statistics reports that the cost of licensed day care for pre-school children had risen 25.8 percent by January 1973. The cost of babysitter services rose 39.2 percent over the same period.^{30a}

It appears then that the 875,000 day care slots can be delivered for \$700 million only if standards for day care are set barely above the "minimum" care level that we have discussed. On the other hand, the figures are not ridiculously high. Using 20 percent inflation and not including food (which could either be billed to the mothers, subtracted from their welfare benefit, or covered by a separate appropriation for "food for children"), the maximum cost for the 875,000 children is \$922 million, about 32 percent above the allotment. Including food, the \$1,016 million figure is 45 percent above the allotment.

³⁰ Council of Economic Advisers, *Economic Indicators, August 1972* (Washington, D.C.: Government Printing Office, 1972), p. 15. The 35 percent figure is for all nonagricultural private workers between 1967 and 1972 (projected).

^{30a} Source: Computer printouts from the Bureau of Labor Statistics, Washington, D.C.

TABLE 6.—*Minimum range costs for standard day care (HEW "minimum" modified)*

	1967 prices per child	Total using 1967 prices	Total with 20 percent inflation	Total with 30 percent inflation
291,000 preschoolers in day care:				
Total cost.....	\$1, 120	\$325, 920, 000	\$391, 104, 000	\$423, 696, 000
Food cost in above total.....	140	40, 740, 000	48, 888, 000	52, 962, 000
584,000 schoolage children in day care:				
Total cost.....	310	181, 040, 000	217, 248, 000	235, 352, 000
Food cost in above total.....	65	37, 960, 000	45, 552, 000	49, 348, 000
Total cost for 875,000 children.....		506, 960, 000	608, 352, 000	659, 048, 000
Total food cost in above total.....		78, 700, 000	94, 440, 000	102, 310, 000
Total cost without food.....		428, 260, 000	513, 912, 000	556, 738, 000

TABLE 7.—*Maximum range costs for standard day care (HEW "acceptable" modified)*

	1967 prices per child	Total using 1967 prices	Total with 20 percent inflation	Total with 30 percent inflation
291,000 preschoolers in day care:				
Total cost.....	\$1, 710	\$497, 610, 000	\$597, 132, 000	\$646, 893, 000
Food cost in above total.....	140	40, 740, 000	48, 888, 000	52, 962, 000
584,000 schoolage children in day care:				
Total cost.....	598	349, 232, 000	419, 078, 400	454, 001, 600
Food cost in above total.....	65	37, 960, 000	45, 552, 000	49, 348, 000
Total cost for 875,000 children.....		846, 842, 000	1, 016, 210, 400	1, 100, 894, 600
Total food cost in above total.....		78, 700, 000	94, 440, 000	102, 310, 000
Total cost without food.....		768, 142, 000	921, 770, 400	998, 584, 600

A much more serious problem results from the \$50 million allotment for the expansion of day-care facilities. There has been rapid expansion in day-care centers over the past decade. Steiner reports that their number tripled between 1960 and 1969.³¹ Using a somewhat different definition, the Westinghouse study found that 17,500 centers in 1970 offered full-time care for seven or more pre-school children, caring in all for 575,000 children on a full-day basis (and caring for additional children part-time).³² But we are now talking about providing 291,000 new full-time day-care slots for preschoolers, an expansion of the industry be over 50 percent in 1 year. It is not so much a question of whether \$50 million will be enough,³³ but whether such an expansion is even possible in 1 year.

If we were serious about immediately training all those mothers who would come under the bill, we might need more slots and/or money. Using current population data extrapolated from previous figures, slightly over 750,000 mothers with almost 1.75 million children aged 6 to 14 would register for work under the bill in 1973.³⁴ Only about 200,000 of those mothers (with 450,000 of the children) now work a half year or more. If we were to train the rest, 1.3 million slots for schoolchildren would be needed the first year. This is more than double the number of slots for schoolchildren included in the 875,000 figure by H.R. 1. Some slots might be provided by babysitters, but only if parents were given some incentive to use such less expensive (and possibly less reliable) arrangements. In any case, since it is unlikely that the training facilities could be expanded so quickly to handle so many individuals, the problem of sufficient day care slots may not be acute. Exactly how the federally provided day-care slots would be apportioned is not discussed in committee documents.

Some mothers with children under 6 might also be expected to volunteer in the first year. Even if volunteers are only those mothers who are already working (and who probably will not require training), some financing of their day care may be required (probably through deductibility). If they do need training, day care will be required, but it is not likely that there would be an immediate need for the 291,000 new preschool slots budgeted for the first year. The real pressure for preschool day care would come after July 1974, when the mothers with children older than 3 are required to work.

The estimates for day care during training in the first year of H.R. 1, thus seem to overestimate the number of preschool slots needed. The need for day care for school age children will depend on how many of the eligible mothers can be accepted for training.

³¹ G. Steiner, *The State of Welfare* (Washington, D.C.: Brookings Institution, 1971).

³² Westinghouse Learning Corp., op. cit.

³³ If the Government had to help all the centers set up, and each center could handle 25 pre-school children, there would be available just under \$4,300 to help fund each center. This might well be enough to finance the needed capital expansion, if the centers could have access to existing facilities—churches, et cetera—that would not need major alterations.

³⁴ This estimate and those that follow are done by Carolyn Lawall in a document for the U.S. Department of Health, Education, and Welfare, Welfare Reform Planning Staff entitled *Population and Cost Estimates for H.R. 1 Child Care*.

PERMANENT COSTS—DAY CARE FOR WORKING MOTHERS

In the first year of H.R. 1, the explicit cost of supporting day care for working mothers (as opposed to those in training) will be relatively low and, since day care is substantially cheaper for school-age children than for those of preschool age, the mothers' wages can be expected to cover most if not all of the cost of care. Day care for four school-age children will cost between \$1,500 and \$2,900, including food. A mother earning \$1.60 per hour receives over \$3,300 per year. In fact, much of the subsidy for day care will be implicit through the deductibility of expenses (see the earlier discussion).

But in later years when women with pre-school children are required to register for work, the situation changes. Table 8 shows the range of costs for standard day care between our maximum and minimum estimates for various family sizes, including food (the cost of food is also listed separately). Clearly, a woman with four children, one of them of preschool age, would have to pay between \$2,460 and \$4,205 for standard care in a day-care center (including food). Will we require that a woman's entire paycheck go to cover day care? ³⁵ The answer will depend on how we interpret the phrase "the mother would be required to pay for the care out of her earnings, *if her earnings were substantial enough*" ³⁶ (italic supplied).

As proposed, the bill would limit the deduction for child care from earnings (in order to determine the size of the benefit payment) to \$2,000 for a family of four, raising it by \$200 per additional child up to a limit of \$3,000. However, for a family of five, standard care may cost substantially more than the \$2,200 allowed as a deduction. Suppose the mother discussed above earns \$3,300 and pays \$3,100 for day care (well below the top cost for standard care). Her income after receiving benefits and paying for day care (of which \$2,200 is deductible before calculating the supplement) is \$2,747. This is below the guarantee level of \$2,800.³⁷ If she has two preschoolers among her four children, the range for standard day care rises to \$3,432–\$5,539. But she must keep her day-care costs below \$3,000 to keep much out of her earnings. Unless there is cheap reliable day care available, this mother faces a crisis: good day care for her children means a drop in her income below the guarantee. She would be better off opening up her own day-care center and employing herself for \$2,900 to care for her own children.³⁸

³⁵ Perhaps more importantly, could we even force such a woman to work when it is so much against her best interest? The experience with unemployment insurance would suggest that when an individual decides that it is in his best interests to be unable to obtain or hold a job, then he will be most successful in doing just that.

³⁶ Committee on Ways and Means, op. cit., p. 167. The italic is mine.

³⁷ The figure of \$2,747 can be easily calculated. Her "taxable" income, for purposes of obtaining the benefit level, is her earnings of \$3,300 minus the \$2,200 child care deduction and the \$720 disregard. This comes to \$380. The benefit level is thus reduced below the guarantee of \$2,800 by two-thirds of \$380. Thus, our mother receives \$2,547 in benefits, \$3,300 in wages, and pays \$3,100 in day care costs, for a net of \$2,747.

³⁸ Under the law, caring for someone else's children is work, caring for one's own is not.

TABLE 8.—*The cost of standard day care for various family sizes*

[The 2 numbers given for each family type represent the minimum and maximum estimates to the nearest dollar developed in tables 3 and 4. Both numbers include food, which is then separated out in brackets for each family size. All the numbers assume 20 percent inflation over the 1968 prices]

		Number of children of school age							
		0	1	2	3	4	5	6	7
Number of children ages 3 to 5:									
0.....	{	0-0	\$372-\$718	\$744-\$1,435	\$1,116-\$2,153	\$1,488-\$2,870	\$1,860-\$3,588	\$2,232-\$4,306	\$2,604-\$5,024
		(0)	(78)	(156)	(234)	(312)	(390)	(468)	(546)
1.....	{	\$1,344-\$2,052	1,716- 2,770	2,088- 3,487	2,460- 4,205	2,832- 4,922	3,204- 5,640	3,576- 6,358	3,948- 7,076
		(168)	(246)	(324)	(402)	(480)	(558)	(636)	(714)
2.....	{	2,688- 4,104	3,060- 4,822	3,432- 5,539	3,804- 6,257	4,176- 6,974	4,548- 7,692	4,920- 8,410	5,292- 9,128
		(336)	(414)	(492)	(570)	(648)	(726)	(804)	(882)
3.....	{	4,032- 6,156	4,404- 6,874	4,776- 7,591	5,148- 8,309	5,520- 9,026	5,892- 9,744	6,264-10,463	6,636-11,180
		(504)	(582)	(660)	(738)	(816)	(894)	(972)	(1,050)

The committee's statement on paying for day care quoted above would seem to imply some form of subsidy to women with lower income and high standard day-care costs. We have discussed the form such a subsidy might take, and clearly it would be necessary to guarantee both an acceptable family income and acceptable day care arrangements to such families required to work. But this may well be economically inefficient.

As we have seen, Government costs in such a situation may rise. This would be of less concern if the families were made better off by these expenditures. But if the mother's yearly earnings, augmented by the present discounted value of her extra future earnings (see note 5), do not exceed the cost of purchasing standard care, then there is a real loss in output to society in her working (that is, the situation is inefficient), even neglecting the value of her housework and her leisure.³⁹ So someone must be worse off, either the Government in higher overall costs, or the mother in lower net income, or the child in below-standard day care, or all three (in comparison with a situation in which the mother is given the basic guarantee and left at home). This is made explicit in equation (7). Redefining both Y^d and W to include the present discounted value of extra future earnings, we rewrite the equation as

$$(Y^d - G_o) = (G - G_o) + (W - C_s) + (C_s - C) \quad (8)$$

where G_o is the guarantee level and C_s the cost of standard care. If W is less than C_s , the cost of replacing the mother's care, then Y^d will fall below G_o unless either G rises above G_o (the Government spends more) or C falls below C_s (the mother uses inferior day care). Only if the parent can obtain lower cost, good care is there a possibility for gain for all parties. For a mother with two pre-school children over age 3, standard day care costs \$4,100 (using the upper estimate); for a mother with one pre-school child and two schoolchildren, standard care costs \$3,500. We might question the gains from requiring mothers with many children to work or accept training, no matter how we pay for the care these children receive.

The policy choice, directly stated, is whether our society is willing to pay more for women with children to work (even after subtracting from the cost the value of the woman's work in helping her to achieve higher future earnings) than for them not to work. Does work have an implicit value (above earnings) to justify any loss in efficiency? The House committee report on H.R. 1 appears to accept higher costs (and inefficiency) on the basis of equity:

More than half of all mothers with children age 6 to 17 are now in the labor force * * * about one-third of mothers with children under 6 are now in the labor force * * * to require such women to support out of taxes on their earnings those mothers who choose not to work but to live on public monies would be inequitable in the extreme.⁴⁰

Of course, if we accept the notion that a natural outcome of income supplement programs is some amount of income redistribution, then taxing working mothers in high-income families to support low-income mothers should not be viewed any differently than the

³⁹ The mother may simply have a comparative advantage over everyone else in producing day care.

⁴⁰ Committee on Ways and Means, op. cit., p. 163.

income redistribution from high- to low-income, male-headed families which also results from H.R. 1. This applies even more if the working women are in two-parent families. But the quotation also refers to horizontal equity, and it is here that we should be more concerned. Women who make a conscious effort to work should not be penalized by a 100-percent tax rate: and this is what welfare reform is about. It is inequitable in the extreme for welfare mothers who earn money to be no better off than other mothers who just receive welfare.

But even accepting the committee viewpoint, we have shown earlier that the fiscal relief to the public of requiring welfare mothers to work is unlikely to be very large in many cases. The committee view that welfare mothers "choose not to work but to live on public monies" implies that running a home and caring for one's children is not "work" (it is nonmonetized). Yet working in a day-care center taking care of children, or as a housekeeper in a wealthy neighborhood is considered work. In a day-care center, a mother can care for more children than at home, yet she also requires materials, space, and supervision, as well as the aid of a trained person. Furthermore, she cannot perform her normal household tasks while caring for children.

· SUBSIDY GIVEN A WORK REQUIREMENT IN H.R. 1

What approach is best to achieve the stated work goals of H.R. 1? Since the committee report stresses the need for adequate care for children, something which would be essential for the program to get political support, some subsidy for day care would seem to be required. Otherwise mothers with high day care costs relative to income would be forced to use poor care to remain economically viable (a dilemma we discussed earlier).

This paper favors some variation on the proportional subsidy scheme developed earlier (option 6, table 5). Of course, the real operation of such a plan would depend first on how the subsidy is related to earnings ($f(W)$). There is some danger in defining $f(W)$ so that $f'(W)$ is too close to 1; that is, the subsidy is reduced almost \$1 for each \$1 earned. Even $f'=0.6$ raises the effective marginal tax rate from 0.67 in the cash grant program to a cumulative rate of 0.87 for those spending 100 percent of C_s on day care. With $C_s=\$3,000$, the day care subsidy tax rate would affect earnings almost to \$5,000. As in the cash supplement program, there is a tradeoff between the amount of the subsidy for persons with low incomes, the work incentive effects of high benefit reduction rates, and high program costs. How the plan would work would depend above all on which estimates for standard care are used. The higher the price set for standard care, the higher will be the program costs, but also the higher will be the quality of day care used. It might seem that the low limit on deductibility recommended in H.R. 1 indicates a preference in the bill for the lower estimates.

This proposed subsidy scheme also maintains a real incentive to use cheaper care when it is reliable and available.⁴¹ Some controls

⁴¹ The workings of the proposal for a parent buying standard care costing \$3,000 are laid out in supp. 3, case 5. If the parent earns \$3,000, it is clear that out of each dollar that the parent can avoid spending for care, he keeps 20 cents (and the Government saves 80 cents). At the same time as we allow the parent to benefit by earning more, it makes sense to allow him to benefit by economizing on services subsidized by the State.

will be needed, however, to prevent obvious abuse. An example might serve to clarify this point. If our \$3,000 wage family can find a relative (say a grandmother or an older aunt), or a neighbor who would be willing to take good care of the children, they might be able to pay \$1,200 for this service (instead of \$3,000 for standard care). From supplement 3, the family's income rises by \$360 if they can do this. But if the family can declare that they are paying \$2,400 for the care, while really paying \$1,400, then the family gains an additional \$760 and the relative or neighbor gains \$200 (since the Government picks up 0.8 of the mythical extra \$1,200). This might also be exploited by local, low-cost day care firms. The fact that the relative would have to pay tax on the full \$2,400 would somewhat mitigate this incentive to misrepresent expenses, but it might be necessary to limit the amounts declarable as day-care expenses for various types of care (for example, by a relative in the parent's home, by a relative in the relative's home, et cetera). This type of abuse would occur in any scheme having some form of deductability, and resembles the normal problems encountered in enforcing tax law against anyone who tries to inflate illegally his income tax deductions.

We might also want to provide some incentive to families during training to economize on their day-care expenses. Perhaps, similar to the proportional subsidy, we might allow a small percentage of any savings to be rebated to the family.

Should such a proposal make an attempt to enforce minimum requirements on the child-care arrangements made? Payment of the tax credit might depend on proving that care met certain standards. This might prove clumsy and insulting, however. Parents have a deep interest in their children and can be relied upon to attempt to buy good care if their incomes are sufficiently high to avoid the dilemma, say, of child care versus food. The proportional subsidy proposal guarantees that no parent—after receiving Government benefits and paying for child care up to the cost of standard care—will have available less than the guarantee-level income. Furthermore, the plan substantially reduces the marginal cost of care, especially to those with low incomes. However, there are some good reasons for Government involvement in the kind of care being used, and these are discussed in the later section on supply.

To hold down costs and avoid the inefficiencies noted earlier, some exceptions to the work requirement should be allowed, exempting single-parent households where the number and ages of children made standard care too expensive. Table 9 presents the families we are discussing in order of their day care expenses. The Government, can involve an estimate on what the average mother is expected to earn. It can then use it to relieve from the full-time work requirement mothers who must pay more than that earnings estimate in standard day care expenses. (If that expected wage were \$4,500, we would exempt families with more than either two pre-school children, or one pre-school child and three schoolchildren, or six children.)⁴² We might retain the work requirement for those on the margin, assuming that enough of them will be able to find cheaper care to yield a net saving. Some kind of part-time, in-home work might be provided for those mothers relieved of the work requirement. Of course, if a mother

⁴² This would appear to create some strong incentives to have children, an issue picked up later in sec. IV.

could make substantially cheaper arrangements for care, she might want to participate in the work force, even without a day care subsidy (but with deductibility). We will discuss the gains available in such an approach below.

TABLE 9.—*Costs of standard care to current AFDC families with 7 or fewer children*

[Standard care costs taken from tables 3 and 4; the costs for a child aged 13 to 18 is taken, arbitrarily, to be one-half that of a child aged 6 to 12]

	Number of children			Number of families	Minimum cost per family	Maximum cost per family
	Aged 3 to 5	Aged 6 to 12	Aged 13 to 18			
Family type:						
A-----	0	0	1	171, 400	\$186	\$359
B-----	0	1	0	223, 100	372	718
C-----	0	0	2			
C-----	0	1	1	103, 900	558	1, 077
C-----	0	0	3			
C-----	0	2	0	159, 000	744	1, 435
D-----	0	1	2			
D-----	0	0	4			
D-----	0	2	1	78, 000	930	1, 794
E-----	0	1	3			
E-----	0	0	5			
E-----	0	3	0	100, 000	1, 116	2, 153
F-----	0	2	2			
F-----	0	1	4			
F-----	0	0	6			
F-----	0	3	1	48, 800	1, 302	2, 512
G-----	0	2	3			
G-----	0	1	5			
G-----	0	0	7			
H-----	1	0	0	121, 500	1, 344	2, 052
H-----	0	4	0	43, 100	1, 488	2, 870
I-----	0	3	2			
I-----	0	2	4			
I-----	0	1	6			
J-----	1	0	1	10, 400	1, 530	2, 411
K-----	0	4	1	24, 600	1, 674	3, 229
K-----	0	3	3			
K-----	0	2	5			
L-----	1	1	0	79, 400	1, 716	2, 770
L-----	1	0	2			
M-----	0	5	0			
M-----	0	4	2	16, 300	1, 860	3, 588
M-----	0	3	4			
N-----	1	1	1	15, 800	1, 902	3, 129
N-----	1	0	3			
O-----	0	5	1	9, 100	2, 046	3, 947
O-----	0	4	3			
P-----	1	2	0			
P-----	1	1	2	65, 000	2, 088	3, 487
P-----	1	0	4			
Q-----	0	6	0	2, 500	2, 232	4, 306
Q-----	0	5	2			
R-----	1	2	1			
R-----	1	1	3	18, 600	2, 274	3, 846
R-----	1	0	5			
S-----	0	6	1	1, 100	2, 418	4, 665
S-----	1	3	0			
T-----	1	2	2	41, 700	2, 460	4, 205
T-----	1	1	4			
T-----	1	0	6			

TABLE 9.—Costs of standard care to current AFDC families with 7 or fewer children—Continued

	Number of children			Number of families	Minimum cost per family	Maximum cost per family
	Aged 3 to 5	Aged 6 to 12	Aged 13 to 18			
Family type—Continued						
U-----	0	7	0	0	2, 604	5, 024
V-----	1	3	1			
W-----	1	2	3	16, 700	2, 646	4, 564
X-----	1	1	5			
Y-----	2	0	0	39, 000	2, 688	4, 104
Z-----	1	4	0			
AA-----	1	3	2	20, 900	2, 832	4, 922
BB-----	1	2	4			
CC-----	2	0	1	800	2, 874	4, 463
DD-----	1	4	1	10, 600	3, 018	5, 281
EE-----	1	3	3			
FF-----	2	1	0	24, 000	3, 060	4, 822
GG-----	2	0	2			
HH-----	1	5	0	9, 700	3, 204	5, 640
II-----	1	4	2			
JJ-----	2	1	1	1, 600	3, 246	5, 181
KK-----	2	0	3			
LL-----	1	5	1	1, 900	3, 590	5, 999
MM-----	2	2	0	17, 100	3, 432	5, 539
NN-----	2	1	2			
OO-----	2	0	4			
PP-----	1	6	0	300	3, 576	6, 358
QQ-----	2	2	1	3, 300	3, 618	5, 898
RR-----	2	1	3			
SS-----	2	0	5			
TT-----	2	3	0	8, 900	3, 804	6, 257
UU-----	2	2	2			
VV-----	2	1	4			
WW-----	2	3	1	3, 100	3, 990	6, 616
XX-----	2	2	3			
YY-----	3	0	0	4, 700	4, 032	6, 156
ZZ-----	2	4	0	5, 300	4, 176	6, 974
AAA-----	2	3	2			
BBB-----	3	0	1	0	4, 218	6, 515
CCC-----	2	4	1	700	4, 362	7, 333
DDD-----	3	1	0	3, 500	4, 404	6, 874
EEE-----	3	0	2			
FFF-----	2	5	0	1, 200	4, 548	7, 692
GGG-----	3	1	1	300	4, 590	7, 233
HHH-----	3	0	3			
III-----	3	2	0	1, 400	4, 776	7, 591
JJJ-----	3	1	2			
KKK-----	3	0	4			
LLL-----	3	2	1	400	4, 962	7, 950
MMM-----	3	1	3			
NNN-----	3	3	0	1, 200	5, 148	8, 309
OOO-----	3	2	2			
PPP-----	3	3	1	300	5, 334	8, 668
QQQ-----	4	0	0	0	5, 376	8, 208
RRR-----	3	4	0	400	5, 520	9, 026
SSS-----	4	0	1	0	5, 562	8, 567
TTT-----	4	1	0	200	5, 748	8, 926
UUU-----	4	0	2			
VVV-----	4	1	1	0	5, 934	9, 285
WWW-----	4	0	3			

TABLE 9.—*Costs of standard care to current AFDC families with 7 or fewer children—Continued*

	Number of children			Number of families	Minimum cost per family	Maximum cost per family
	Aged 3 to 5	Aged 6 to 12	Aged 13 to 18			
Family type—Continued						
ZZ-----{	4	2	0	200	6, 120	9, 646
AAA-----{	4	1	2			
AAA-----{	4	2	1	100	6, 306	10, 002
BBB-----{	4	3	0	100	6, 492	10, 361
CCC-----{	5	1	0	100	7, 464	11, 698
CCC-----{	5	0	2			

NOTES

All other 7-child families have no families in each category where we measure to the nearest 100. The breakdown on larger families is not available but there are: 32,200 families with 8 children; 16,600 families with 9 children; and 11,000 families with 10 or more children.

Note that this includes all those families with children under 3 years old, which we have excluded above. 38.4 percent of the families with 6 children and 42.6 percent of the families with 7 children included at least 1 child under 3 years of age (and hence not required to register for work under HRI).

Source: Institute for Research on Poverty, University of Wisconsin. Calculations based on these figures or this table and throughout the paper, have been omitted for brevity (especially in tables 10 and 11 but are available on request from the author.)

THE COST OF DAY CARE DURING PROGRAMS

a. Day-care cost for single-parent families during training

We assume that we will train for a period of 1 year, only those mothers who now work less than one-half of each year. We also assume that the families with pre-school children who are not required to register for training until the second year of the program will not volunteer for training in the first year. The calculations are shown in supplement 4. Care for all these children will cost between \$1.1 and \$2 billion over the first 2 years (using our range for standard care and 20 percent inflation over 1967 figures).

Now turn to those families with children under 3 years of age. If we assume that they will not have further children,⁴³ those who do not now work more than a half year will require training when the youngest child reaches age 3 over the next 3 years. Day care for these children will add costs of between \$1.6 and \$2.6 billion spread from 1973 to 1975. These calculations are also shown in supplement 4.

The total range for the cost of day care while training all eligible mothers under H.R. 1 is \$2.7 to \$4.6 billion. If training requires less than 1 year, costs will be reduced proportionately. We also assume that we will have to pay for full standard care for all these children. Under an incentive scheme some families could provide lower cost care, but it is hard to estimate the resulting cost savings,⁴⁴ although of course it would lower the costs. Finally, by deferring to the future the training for mothers with large and young families (and high day care costs), a further reduction in costs is possible (for this part of the program).

⁴³ This may seem a little farfetched. However, if they do have children, the expected age distribution of their children, under 14 years of age, when they finally do qualify for training should be the same. Their day care training costs are not altered, only put off into the future.

⁴⁴ Current WIN experience, for example, is misleading, because it tends to attract those who have available low-cost care.

After these mothers are all trained, Government day care payments for trainees should fall abruptly. There will be some new mothers entering H.R. 1 each year, but the number of trainees will be very low.⁴⁵

b. Day care for single-parent families during work

It is difficult to separate the costs associated with a scheme of support for day care through deductibility, and those associated with a direct subsidy (such as we outlined at the beginning of this section). Of course, in comparison with a system with a general work requirement and no deductibility, allowing the deduction of day-care expenses will be very expensive. Not only will the potential payments to those working and on welfare rise, but payments will also be made to eligible families who otherwise would not qualify. But some support for child-care expenses is an integral part of a work requirement, a requirement that is politically unacceptable without some consideration for child care. The Ways and Means Committee clearly commits itself to some support for day care (see our earlier discussion). If support for day care raises the potential welfare bill, it also lowers it by enabling families to earn income. It is more useful to compare total expenditures under two arrangements. In one, work is required and some subsidy-deductibility scheme is adopted for day-care expenses. In the second, single parents do not work but receive the minimum guarantee under FAP. The total cost or saving of requiring work of adults in single-parent families can then be seen clearly.

This cost can be calculated using the breakdown of current AFDC families in table 9. We assume the proportional subsidy plan as developed earlier (with $f(W)=0.6W$) and also assume that every family will use standard care (that none will find cheaper care, despite the incentives).⁴⁶ Compared to a system of just paying out the guarantee with no work by the parents, the total difference in costs to the Government for all families in table 9 can be derived using two different possible average yearly earnings (\$3,000 and \$4,200)⁴⁷ and the two ends of our range for standard care. Again we assume that day care for each child aged 13 to 18 would cost one-half that of a child aged

⁴⁵ Estimating the number of new mothers who will need training each year is very difficult, since many of them might have received training before, and in any case we are trying to estimate children who are not yet born. But if we imagine a generation to last 25 years, and assume that our total training costs would be spread out over that period, rather than concentrated, once the program becomes on-going, we are clearly talking about an abrupt decline in costs, from \$4.6 billion over 3 years to under \$200 million per year (using the top figure).

Another factor may, however, increase the day care costs during training in the future. We have, thus far, assumed that each adult need only be trained once before participating in the labor force. It may develop, however, that we need to retrain these workers periodically as jobs disappear and new ones appear. This would substantially increase all training costs.

⁴⁶ Since this is obviously not the case, the potential gains to a work requirement will be understated. With a reliable distribution of day care expenses, new calculations could easily be done. However, it is important to note that this subsidy encourages, relative to the no subsidy case, the purchase of better care by new workers and by those women now using cheap care. Just what the final day care distribution would look like is unclear.

⁴⁷ The two numbers are arbitrarily chosen, although they might serve as a range for possible average earnings. The calculations are easily redone for other average incomes.

6 to 12.⁴⁸ Some families under these assumptions would cost the Government more under the work requirement and some less. The totals for these two groups (gains and losses), and the sums are shown in tables 10 and 11 (the calculation for a sample family in table 12).

Consider the numbers in tables 10 and 11. To place these figures in perspective, supporting all those families at the projected FAP levels would cost a total of \$3,391,250,000. So using the low estimate for day care and assuming all mothers can earn an average of \$4,200, we can save 65 percent of the FAP costs by requiring them all to work. But the savings can even be increased by eliminating those families who would cost more under the subsidy plan. The potential gains in such a move are more substantial using higher day-care costs and lower wage estimates. Using wages of \$3,000 and the high estimates for standard care, the subsidy will add 9.3 percent onto the FAP-level costs; but if we can eliminate the families that cost more, the work and subsidy plan can lower potential costs by 18.9 percent. It should be noted that the gains and losses developed here, omit all those families with eight or more children, where the work requirement is likely to cost us a substantial amount per family (there are almost 60,000 such families).

How would the families in tables 10 and 11 fare under a work requirement and proportional subsidy scheme? It can be seen in table 5 that no family can lose income (compared with the FAP guarantee level). The total increase in net income to these families after paying for day care and receiving the benefit may be computed easily. Setting $C=C_s$ in equation, we obtain

$$(Y^a - G_o) = (G - G_o) + W - C_s \quad (9)$$

Adding over all the AFDC families with seven or less children, this states that the total net income gained by these families under the work requirement is the sum of three quantities: the increase in Government expenditures (calculated in table 10), the total wages earned, and the negative of the total child-care expenditures. Total wages are obtained by multiplying the 1,511,300 families in table 9 by the average yearly wage; total child-care costs are easily derived from table 9. The results are shown in table 13.

TABLE 10.—*Gains and losses to the Government, using a proportional subsidy and work requirement, as against FAP with no work by parents in these families*

Cost of standard care	Wage level	
	\$3,000	\$4,200
Low estimates.....	+ \$1, 138, 764, 400	+ \$2, 247, 038, 400
	- 206, 248, 600	- 41, 496, 300
	+ 932, 515, 800	+ 2, 205, 542, 100
High estimates.....	+ 640, 514, 700	+ 1, 549, 546, 700
	- 956, 585, 000	- 458, 933, 900
	- 316, 030, 300	+ 1, 090, 612, 800

⁴⁸ This may be projecting costs too high, especially for children between the ages of 15 and 18. In many homes these children currently dispense day care to their younger brothers and sisters while their parents work. On the other hand, children at the lower end (13 to 14), may need more care than this.

TABLE 11.—*Gains and losses from table 8, by family size*

Number of children	Low estimate standard care costs		High estimate standard care costs	
	\$3,000 wages	\$4,200 wages	\$3,000 wages	\$4,200 wages
1-----	+494,824,000 0	+842,184,000 0	+357,244,100 0	+754,810,100 0
2-----	+321,342,400 -22,152,000	+610,134,400 0	+199,365,600 -128,762,400	+437,716,800 -36,816,000
3-----	+185,453,200 -31,303,600	+406,638,000 -4,098,400	+71,944,200 -180,049,300	+230,720,400 -72,056,700
4-----	+91,211,600 -43,858,400	+227,363,200 -8,908,000	+11,863,600 -202,376,900	+98,599,200 -98,600,600
5-----	+33,377,600 -41,492,600	+103,054,200 -9,400,200	+97,200 -187,130,700	+25,465,200 -94,651,400
6-----	+10,861,600 -38,110,000	+43,760,400 -9,537,300	0 -155,179,000	+2,177,000 -87,778,900
7-----	+1,694,000 -29,332,000	+13,904,200 -9,552,400	0 -103,086,700	+58,000 +69,030,300

TABLE 12.—*Sample calculation for family P—Net Government gain or loss (see table 9)*

	Wage level	
	\$3,000	\$4,200
Low-cost standard care (\$2,088)-----	+\$34	+\$928
High-cost standard care (\$3,487)-----	-1,367	-327

NOTE: For calculation see table 5. Minimum guarantee is \$2,400.

TABLE 13.—*Average gain per family in net income (after day care and benefits) using a proportional subsidy and a work requirement, as against FAP with no work by parents in these families*

Cost of standard care	Wage level	
	\$3,000	\$4,200
Low estimates-----	\$1,130	\$1,488
High estimates-----	1,029	1,298

It might be argued that it would be unfair to disqualify families from the work requirement and day-care subsidy to avoid the extra costs. Indeed, for some families near the margin (those that would cost only slightly more under the plan), it might be desirable to allow them the option of registering for work. But, for large families with young children, the cost in resources is very great. The choice might well be to allow these families to register for the subsidy, or to use resources to increase the general guarantee level.

Alternative 2: Guaranteed Job Opportunity

This alternative, proposed by the Senate Finance Committee, requires work by eliminating the minimum income entirely for

"employables." For all families other than single-parent families with children under 6 years old, welfare will no longer exist. Instead, public work will be provided at \$1.50 an hour for up to 32 hours to all those who cannot find private employment. Private work at between \$1.50 and \$2 an hour will be subsidized at 75 percent of the difference between the wage and \$2. An additional 10 percent bonus will be paid on all incomes up to \$4,000 per year, the bonus falling to zero as income raises to \$5,600.⁴⁹

THE TREATMENT OF DAY CARE

Day care is less important in this proposal, since all one-parent families with pre-school children are exempt from the work requirement. For women with children over 6 who take federally funded jobs, the Senate Committee states:

However, a woman with school-age children would not be required to be away from home during hours that the children are not in school (unless child care is provided), although she may be asked, in order to earn her wage, to provide after-school care to children other than her own during these hours.⁵⁰

This still leaves day care to be provided during the summer. The spirit of the report indicates that some of the women would be employed to supervise their own and other children. This amounts to a 100-percent subsidy for day care for all women working at the federally provided jobs, since they all take home the Government salary of \$2,500, and pay nothing for day care, whether they are being paid to supervise their own and other children, or are receiving the services of other mothers.

But how are the mothers who do not take federally funded jobs to be treated? The report states:

Subsidization of child care for low-income working mothers will depend on the availability of appropriations. Mothers able to pay will be charged the full cost of services.⁵¹

What is meant by "able to pay"?⁵² If day care for mothers earning \$2,500 is fully subsidized, the subsidy would have to be reduced gradually with increased income to keep the effective marginal tax rate fairly low (and maintain the incentive to secure private employment). For each extra dollar of annual take-home income, we might require that some fraction go toward day care, until the mother has assumed the whole cost. The actual effect on the effective tax rate will depend on which tax rate is being considered. This scheme has two tax rates, the tax rate on extra income earned by accepting a job paying a higher per-hour wage rate and the tax rate on extra income earned by working more hours.

If the worker earns less than \$4,000 per year (and hence earns the full 10 percent bonus) at a private wage of \$1.80 per hour, then working an extra hour gains him an extra \$2.13 (\$1.80 plus 10 percent of \$1.80

⁴⁹ U.S. Congress, Senate Committee on Finance, *Social Security and Welfare Reform, Summary of the Principal Provisions of H.R. 1 as Determined by the Committee on Finance* (Washington, D.C.: Government Printing Office, 1972). See especially p. 63 onward.

⁵⁰ *Ibid.*, p. 73.

⁵¹ *Ibid.*, p. 92.

⁵² This rather resembles the phrase "the mother would be required to pay for the care out of her earnings, if her earnings were substantial enough," quoted earlier from the House passed version of H.R. 1. The same sort of implied subsidy seems to exist here.

plus three-quarters of the difference between \$1.80 and \$2). This represents an effective marginal tax rate of -18 percent (an added benefit of 18 percent per extra hour worked). Requiring him to pay a fraction, g' , of his take-home increment⁵³ toward day care will make the tax rate $1-1.18(1-g')$.⁵⁴ If $g'=0.4$, the effective tax rate on the original earned income becomes 29 percent; if $g'=0.6$, it becomes 53 percent.⁵⁵ If, on the other hand, the worker takes a higher paying private job with a wage of \$1.90, his take-home pay rises to \$2.165 (\$1.90 plus 10 percent of \$1.90 plus three-quarters of the difference between \$1.90 and \$2), making for an effective marginal tax rate on wage-rate increases of 65 percent. Paying g' of the increment toward day care makes the effective tax rate $1-0.35(1-g')$. If $g'=0.4$, the effective marginal tax rate becomes 79 percent; if $g'=0.6$, it becomes 86 percent. These rates are rather high, but inevitable given the plan's high rate of effective tax on wage rate increments in this range. This may be of less concern than tax rates on the extra hours worked.⁵⁶ But the earlier transformation of the negative tax rate on extra hours of work to a substantial positive rate points out the basic problem: any attempt to reduce a subsidy fairly rapidly as income rises will make for a high positive tax rate, no matter what the original features of the plan.

Of course we would want to encourage parents to use cheaper care if it were available. To do this, parents who use cheaper care might be paid a bonus of some fraction of every dollar saved the government in subsidies. This fraction might be 0.3 or 0.5. If, however, the government employs mothers in Federal jobs to care for other women's children, then day-care costs would be part of the Federal wage bill for the plan. It might be undesirable to pay a partial subsidy for private day care arrangements when the mothers providing it are not easily employable elsewhere in the government. The bonus might be cut to 0.1 or even zero, since parents using cheaper care would then not save the government much.

Some limit might be set on the size of the family whose single parent would be employable in order to discuss some of the inefficiencies dis-

⁵³ By "take-home increment" I mean the total increase in his income from work resulting from the extra hours worked. This increase includes the Government wage subsidy and the bonus.

⁵⁴ If he works 1 more hour, he earns \$1.80 more and receives an additional \$0.33 from the Government. But if he is obliged to pay an extra $2.13g'$ for day care, he gains only $1.80 + \$0.33 - 2.13g' = 2.13(1-g')$. As a fraction of his original extra earnings, this is $\frac{2.13(1-g')}{1.80}$. The effective marginal tax rate is thus

$1 - \frac{2.13(1-g')}{1.80}$ or $1 - 1.18(1-g')$.

⁵⁵ However once the worker is earning above \$2 an hour, he is also earning more than \$4,000 annually (if he is able to work full time), and so he has the \$400 bonus at \$4,000 reduced by 25 cents for every extra dollar earned. The negative marginal tax rate he enjoyed at a lower wage has become a positive rate of 25 percent. There will be many families still receiving day care subsidies at this point, and reduction of this subsidy as income rises will make this tax rate much higher. If $g'=0.5$, then at the annual income of \$4,400 after the subsidy, the family must pay the first \$950 of day care expenses and the effective marginal tax rate is $62\frac{1}{2}$ percent.

⁵⁶ However, this feature is vulnerable to attempts by part-time workers to conceal their true wage rate if it is high, and to both inflate the number of hours worked and deflate the reported wage rate. There is also a serious reduction in the incentive to leave Government employment and seek private work if g' is too high.

cussed earlier. Without a limit cases will arise in which child care costs more money than is earned by the parent. However, the lower cost of care for children in school compared with the cost for pre-school children makes this issue a somewhat less powerful one.

The cost of child care could be reduced by using some of the public employees as day-care workers, since their wage of \$2,500 per year is well below the cost used in the HEW calculation (\$4,400 per year). Even at the "acceptable" supervision level of one adult to 15 children, this comes to only \$173 per child in immediate labor costs. Unfortunately, this work would be only part time (even less than the 32 hours per week of guaranteed employment), so something else would have to be found for the employees at other hours. These workers might also work in day-care centers for mothers of preschoolers who want to work. Here we see the difficulty in calculating government costs for day care under such a plan, if many of the resources used to provide day-care cost the Government relatively little. The alternate "uses" for day care mothers may not be very productive.

The specific day-care cost in the workfare program would depend critically on how much mothers could earn and on what day-care arrangements they could make. A 1969 AFDC study of working mothers with schoolchildren found the following day care arrangements:⁵⁷ of 100 children, 29.2 were cared for by a relative in the child's home; 7.7 by a relative in the relative's home; 10.9 by a nonrelative in the child's home; 15.2 in formal day care (12.5 of these in family day care); and of the 36.8 others, 16.7 looked after themselves, 7.1 went to work with their mother, and 13.0 were unknown. If most of the last 36.8 percent require care, there will be 52 percent in day care. But as was indicated, this number may well be higher when the whole AFDC population is taken into account.

If parents do pay for food in all cases, day care can cost at most \$640 (see table 4). Since the minimum income of \$2,500 in Federal jobs is low, we might want to separately fund food for children. Applying the \$640 to the 777,000 families with 1,729,000 children which would come under H.R. 1, the potential costs are \$1.1 billion. If we pay for day care only during the summer,⁵⁸ the number drops to \$630 million. But 26 percent of these children are in families whose mothers now work at least half the year, and half of them use low-cost care. Assuming that half as many of the nonworking families (that is, 24 percent of them) also would have access to low-cost care, we have 524,000 children in lower cost care. Averaging the lower cost care to \$200 per child per full year, and paying one-quarter of the savings to parents as a bonus (\$110), the bill for day care drops by 15 percent. Since many mothers will earn above the minimum, even if the average is only \$3,328 (the minimum wage of \$1.60), families will be expected to pay for part of the day care. This will reduce the cost further, depending on the effective tax rate chosen. But separating out the cost we can call "day care" is difficult, especially if we use day care as a way to employ the working mothers in Government jobs.

⁵⁷ Carolyn Lawall, *op. cit.*, p. 7. These figures come from the 1969 AFDC survey table 29 (NCSS AFDC-3).

⁵⁸ Since public work is provided only 32 hours per week (6.4 hours per day), day care might not be needed while school was in session.

Exact figures will depend upon estimating accurately the number of mothers who will secure private employment and the size of their earnings.

Alternative 3: Universal Demogrant Plan (UDP)

One particular UDP might grant \$1,200 per adult and \$600 per child, then tax any income earned by an individual at a flat rate (say 32 percent), with very limited deductions. There are no work requirements at all. This provides the best opportunity to deal rationally with the issue of child care. Since the UDP distorts as little as possible the individual's incentives to work rather than requiring him to work, no Federal provisions for day care need be made, except as outlined in section V. If there is a work requirement then the issues are the same as those dealt with in alternative 1, but with a higher guarantee level.

Since standard day care is clearly a legitimate work-related expense, it ought to be fully deductible. Any day-care expenditures beyond this level ought to be viewed as consumption and nondeductible. While wealthy working parents might consider higher quality care as essential before they work, any other arrangement will tend to overcomplicate the tax structure. This higher quality care would represent consumption, rather than a simple replacement of the mother's supervisory and developmental care. The standard for care should be set at the legitimately high level of \$2,052 for pre-school children. While parents can spend less than this, we would hope they would act on the best interests of their children. In extreme cases of inadequate care, the parent correctly might be accused of misusing the \$600 grant to his child and instructed to either improve the child's lot or face outside control of the grant. But this would be a rarity. And in any case, this would be an issue whether the parent is working or nonworking, rich or poor.⁵⁹

This approach forces the parent to face the true social cost of working. If the economic gains and possible utility of working are not sufficiently above the standard child-care costs to justify the loss of leisure and productivity in the home, then the individual will not work and probably should not. The marginal tax rate will distort this somewhat, but this is an unavoidable result of all practical taxes.

In terms of costs, the UDP is such a radical departure that it is impossible to consider only the cost of child care. One thing bears special mention. Both other plans involve coercing people to work, in many cases for dubious overall gain once standard day care and housework are netted out. The UDP, by allowing choice, stands to make many people better off. It also probably will save money by reducing administration costs, and will reduce any loss of efficiency from forced work, in comparison with the other more complicated plans that require work.

The cost to the Government of day care would be in its deductibility. While eliminating the full deductibility of standard day care might be able to reduce substantially the overall tax rate, even this is not certain. While some working mothers would then have to declare more income, some others might cease working altogether and depend on the grant, increasing Government expenditures. The full cost of

⁵⁹ To collect the \$600 per child, a working parent might be required to prove that adequate care was being provided, but such a requirement would be costly, tedious, insulting, and very much counter to the general aims of a UDP.

deductibility is not easily estimated, but it would probably be high. Nevertheless, allowing deductions for day care is appropriate in enabling rational work decisions and encouraging workers to purchase high quality day care, as well as for horizontal equity.

There is no explicit support for child care under a UDP. It is possible to graft a work requirement onto the UDP, but in that case we would be dealing essentially with another version of H.R. 1, this time with higher guarantees. These higher guarantees would substantially reduce the need for day care subsidies, but the further structure of the UDP and H.R. 1 would be very similar.

IV. OTHER ISSUES

In this section some other issues related to day care will be sketched briefly.

1. *Family size.*⁶⁰—There is some concern about the State assuming too many of the costs of children. Since unsupported children in poor families represent a very real cost to society, one might argue that society ought to give parents some disincentive to having children they cannot afford. Subsidized day care, especially as proposed for the first two income plans above, substantially reduces the cost of extra children to the working poor; and the UDP at least partially absorbs the costs of children. And currently, aid to families with dependent children increases family benefits for each new child.

Unfortunately, there is no resolution to this problem. Although we might like to pose serious disincentives for conceiving an additional child, actually imposing penalties once the deed is done can only reduce the welfare of the whole family, not incidentally including the children.

Consider the effects on family size of the various plans considered in this paper (each of which views work by mothers more positively than AFDC). In comparison, the current AFDC situation does not discourage childbearing, since each extra child brings in more benefits and solidifies the mother's place on the welfare roles. The high disincentive to work in the AFDC program also means that there is no real disincentive to having more children. With a more positive attitude toward work, mothers with one or two children would have a real incentive to avoid bearing more children so that they could work and raise family income once their children were old enough. With a heavy disincentive to work, this benefit for not having more children is not available. Giving mothers a chance to work and escape from poverty would mean that new babies would be treated as an interruption and an inconvenience. One problem with both H.R. 1 and the workfare plan is that they offer incentives to have the first child, especially for an unskilled young girl. The likely effect on families is unclear.

Some of our proposals to limit the types of families required to work and receive day care subsidies would seem to offer incentives to have many children (to avoid work). If the only work available to mothers is both low paying and unattractive, we might expect mothers

⁶⁰ Glen Cain has treated the effects of income maintenance plans and particularly day care arrangements on the birthrate in "The Effect of Income Maintenance Laws on Fertility in the United States," Poverty Institute Discussion Paper 117-72. See especially pp. 19-31.

to try to escape the work requirement. On the other hand not having an exemption for large families from the work requirement will not eliminate this problem. Under H.R. 1, mothers with children under age 3 are exempt from the work requirement, so a mother desiring to escape work need only become pregnant once every 4 years. This seems an easier route out of work than the large-family exemption, which would demand six or possibly more children over the age of 6 to qualify. It is unlikely then that a proposal to eliminate the work requirement for large families will substantially increase whatever incentive to bear children that exists.

2. *Transfers to children.*—Quite aside from day care, we may want to try to help poor children directly. Such a goal should not be tied to the parents' decisions on work. The children in day care centers can be reached easily with better medical care, food, special education, and social work. But these aids should not be denied to children whose mothers do not work. Vouchers for medical care, food, and education could be issued to poor parents as part of their supplement. If the child is in day care, these vouchers could be used through the center. But if the parent does not work, clinics, nursery schools, and other facilities might serve the children.

3. *Discrimination.*—Segregation by income may be the inevitable result of day care. This may not concern us, since society is residentially segregated anyway and young children are usually raised within the immediate neighborhood of their homes. But the danger of splitting society into two groups, one of them well off and raising their children at home, and the other poor and placing their children in day care, may be of more interest. Segregation exists in any case, much of it *de facto*, and it is not surprising that it overlaps into child care. Rich children do not sit with poor children at ball games or restaurants, and they do not play with them around their homes in the suburbs. In fact, some of the motives for universal day care are to compensate for precisely this segregation by deliberately bringing children together at an early age.

There are some things we can do to reduce this segregation (and perhaps will have to do, depending on the extent to which federally financed day care legally will have to meet standards of racial desegregation). Some busing of pre-school children might be possible. Generous scales of subsidization and the requirement that day care centers be open to all applicants could reduce discrimination within an area. But unless we are prepared to require day care for all, there seems no way to avoid the fact that there will be many more poor children than rich children in day care centers.

4. *Horizontal equity.*—Many of the arguments raised in this paper have concentrated on horizontal equity among families with different numbers of children. Mothers with large numbers of children with no second parent present are at a real disadvantage as against two-parent families, where one parent can work outside the home to support the other working within the home. We, therefore, treat them differently. This view treats children as a general responsibility and investment of society, which must intervene in case of breakdown of the normal mechanism for protecting children, the two-parent family.

It is possible to take another view, that children represent a consumption decision made by parents, and that any subsidies toward child raising for parents with large families is an unfair burden on

other adults, most particularly those who have chosen to have few children or none at all.⁶¹ Yet the entire tax structure testifies to the fact that Americans have chosen not to consider expenses for children as pure consumption. More to the point, children, while they may be partially a consumption decision by their parents, also are citizens in their own right. Reaching poor children with aid, by increasing the incomes of their parents (or by subsidizing their day care), is as important a goal in welfare policy as reaching the poor parents themselves with aid.

5. *What are the long-run effects?*—Is it really desirable to replace a parent with day care in a center? Do children raised in day care centers grow up to be different types of people than those raised at home? At what age can a child realistically be placed in a day care center? Day care would last for longer hours than public school now does for most children, and would start at a much earlier age. Does it represent a promising new way to improve the lot of children and their parents, or a trap for those who want to separate mothers from their children for whatever reason?

V. FEDERAL INTERVENTION IN SUPPLY

Much concern has been given to providing the day care required under H.R. 1 and the Senate Finance Committee proposal. In H.R. 1, the Secretary of Labor is expected to secure child care for trainees and workers, where possible using those facilities developed by HEW. HEW would plan for child care, construct facilities, provide assistance, set standards, and maintain quality control.⁶²

S. 2003 would establish a Federal Child Care Corporation, designed so as to not lose money, to provide child care to welfare recipients, either by contract with other facilities or through its own organization. The Corporation could finance new construction, but would be supported by fees.⁶³

A number of the proposals would require a very large expansion in the supply of day care in a very short period of time. In addition to this quantitative change, there would also be a qualitative change in the basic nature of the industry, if only because of the fact that much day care today is very decentralized and disorganized, often depending on the charity of church groups or uncertain funding from various agencies. Large-scale Government programs requiring reliable day care would call for a more disciplined response to demand. And if the Government is to become involved in financing a large chunk of day care and/or requiring its use by a sizable group of parents, some concern for how the sector will perform is required. This section, after a brief discussion of the household as a unit, will first consider some of the particular properties of day care that seem to make it unsuited

⁶¹ Do all parents make the decision as to family size consciously? The question of what is an unfair burden might also be turned around. Since society desires to reproduce itself, it may be fair to ask those families who choose not to have children to share in the cost of raising the next generation.

⁶² Committee on Ways and Means, *op. cit.*, pp. 192–194.

⁶³ U.S. Congress, Senate Committee on Finance, *Material Relating to Child Care Legislation* (Washington, D.C.: Government Printing Office, 1971), p. 20.

to the private market and then examine some alternatives before proposing a possible direction for organization.⁶⁴

1. *The Decision To Use Day Care*

The decision by a family to use day care resembles that by a firm to either produce something itself or go out to buy it on the market. When the firm makes something itself, it avoids the need to worry about how the other firm is doing the job and can thus save the transaction, bargaining, and overview costs. Traded off against this is the fact that a specialized producer is apt to be more efficient than the firm (which if it itself produces probably will do so on a small scale).

The household must make decisions on how specialized it will be; that is, just how much will it do for itself and how much will it trade with the outside. Unlike the firm, however, the household is limited in size. Furthermore, ignoring the labor-leisure choice, the family has fixed resources (especially time), and must decide how best to use them. In deciding to use day care, the family is opting for greater trade with the outside, and its decision depends on the same two factors discussed above. Is there a specialized producer with a comparative advantage in producing child care? And if there is, what is the additional cost in assuring quality and availability of that care? The first question touches on our earlier discussion on how mothers evaluate working. To obtain the parent's "cost" of producing care at home herself, one takes the opportunity cost of the parent's time and subtracts the value of additional household tasks performed simultaneously with child care (and subtracts or adds the relative preference for working at home or outside). Except for the high emotional content of child-raising, this question is not altogether different from what any individual asks before deciding in "make or buy" situations. But the second question focuses on the particular nature of child care as a good or service.

2. *Day Care as a Commodity*

In theory the consumer normally is assumed to be an expert at judging the quality of the goods and services arrayed before him in the marketplace. When choosing oranges, he has some real idea that he wants sweet, juicy oranges. And even when he is fooled by oranges altered by dyes or picked at the wrong time, he can later recognize that he has been fooled (when he actually eats the oranges), and make a mental note to switch the type of oranges he buys: "Brand A's oranges are doctored—next time buy Brand B's." He can even refuse to buy oranges again and switch to a close substitute. Moreover, the costs of uninformed choices are not likely to be serious, and the addition of some Government overview to prevent dangerous practices (poisonous or disease-causing dyes) is felt to make consumer preference vastly superior to any other evaluatory mechanism.

⁶⁴ Much of the argument in this section has already been developed in a slightly different manner and in somewhat more detail in the Urban Institute (Washington, D.C.) paper by Richard R. Nelson and Michael Krashinsky (1205-2). *Some Questions Regarding Optimal Economic Organization—The Case of Day Care for Children.*

In considering day care for young children, we cannot be so sanguine. The costs of a poor choice are apt to be much larger and less temporary, especially because the consumer is not able to judge quality accurately even after he has started using a particular day-care center. The child, rather than the parent, receives the day care, and the preschooler is hardly able to evaluate the care he receives. The conscientious parent, by occasional visits to the center and close attention to the child's comments, can get some assurance that the care is not horrendous. But beyond this, the inability to know what is going on creates a very serious problem of reliable display. There are few easily observable and objective facts on which to base evaluation. Moreover, since day care is only needed for a very few years, parents who do learn something about what makes for good day care and register their perception by patronizing the better centers are soon no longer in the market.

3. Organizational Alternatives: Why Not Private Enterprise?

We are specifically interested in how well two disjointed processes will function under different organizational regimes for day care. The first is evaluation, the second, adjustment. Evaluation is the mechanism by which the day care sector and its individual centers are assessed in terms of benefits and costs, and how the results of this assessment are communicated to those organizations responsible for supply. Adjustment is how those organizations, in turn, respond in terms of supply to that communication. Under different regimes, different groups evaluate day care, often from different perspectives, and of course adjustment proceeds in different ways. This schema provides us with a framework for considering how day care might best be expanded.

The private enterprise market has traditionally been viewed as the most efficient way to produce a commodity and respond to changes in consumer demand, yet there seems to be an almost universal suspicion that private, for-profit firms and an open market are an unsatisfactory way to organize day care. Unregulated private enterprise today supplies a significant fraction of institutionalized day care. It is apparent that most day-care specialists consider this unfortunate, and indicative of the undersupply of more adequate care. Why is this so? ⁶⁵

In free enterprise, evaluation is carried on regularly by consumers who decide what to buy. Supply adjustment occurs by firms seeking profits. Popular products attract entrepreneurs; unpopular products lose money and, therefore, producers. The discussion above focussed on how evaluation by consumers was inadequate. But the profit motive complicates this.

Normally, quality is assured by the workings of the market. Shoddy items do not sell, so quality becomes a condition for profitmaking and the public is best served by firms aiming primarily at high profits. But where display is a problem, this breaks down. Quality care will result only if it yields more profit than providing poor care and cutting costs in ways not easily seen by parents. And if parents do not recognize quality care, then there is an incentive for firms to cut corners.

⁶⁵ This may be partially because they believe that people ought to use more expensive care. But we suspect that they are also very suspicious of the for-profit day care firm per se.

This is why there is a widespread belief that proprietary day care ought to be carefully regulated by some public body. State standards would then share part of the evaluation responsibility with the consumer. But enforcement of the letter of the law cannot guarantee the spirit of the law. Those qualities that are easily measurable—space, fire safety, health safety, supervision ratios—only scratch the surface (and besides, they already are most obvious to the parent). It is impossible to exclude with laws the many possible ways to cut costs and quality. And close regulation is very expensive, especially in a decentralized industry like day care.

It may well be that many profitmaking center operators are in business because they enjoy caring for children, and have a given profit level as a constraint, not as the sole aim. But if so, then we are no longer talking about the sector as the traditional competitive model. If “better” centers cannot drive out “poorer” centers (by making higher profits, expanding, and so forth), then the major benefits of competition are lost.⁶⁶

4. *Public Provision*

If there is danger in the mechanism of supply adjustment strongly driven by profits, then we ought to consider organizational forms driven by other motives. Provision of day care by a public agency has much in common with the employment relationship described above. The consumer is a pure public provision situation loses the large range of choice available under a private system. Yet he usually can trust the supplier not to try to turn a large profit at his expense. Public enterprise is run by officials who generally can be selected to run the system in the public interest, and who often can be replaced politically if they fail to do so. But there is a widespread resistance to public provision.

The reasons parallel some of the current reaction against monopoly public provision of education. The public bureaucracy is slow to change in the face of public pressure. Unlike the traditional employment relationship, the employer here is collective (and “firing” in the bureaucracy is no easy task). The judgments of consumers are executed through votes for representatives and direct and indirect pressure on the bureaucracy running the system. Evaluation is thus through “voice,” not “exit.”⁶⁷ Public provision tends to put too little emphasis on individual judgment and variations in tastes.

In public provision, professional judgment can be brought to bear on the evaluative process directly through studies and hearings. But the bureaucracy seems reluctant to change without an overwhelming public support, and this would argue for a more decentralized system in which new ideas can be more easily made available to consumers. There is no general agreement among experts on exactly what “good” day care is, so that formal evaluation by experts cannot control public

⁶⁶ There may be some people who feel that competition will work in day care to best serve the consumer by eliminating the inefficient firms and insuring quality. Groups of day care centers under one brand name would develop and regulate themselves to guarantee a reputation for high quality. The author does not agree. If consumers cannot judge quality accurately, then there is no reason for profit-seeking firms or groups of firms to be concerned about the quality of their care (although they will all claim to have high quality standards). Competition works only when consumers can recognize what serves them best and purchase it, forcing the inefficient and the “overpricers” out of business.

⁶⁷ Albert Hirschman’s terms, see A. Hirschman, *Exit, Voice, and Loyalty* (Harvard, 1970).

day care reliably (public enterprise debates often focus on who can produce the most "experts").

Providing choice in a regime of public sector production is not yet workable. For "exit" to work, popular center directors would have to have a real incentive to vary their programs, and, if they succeed, must have access to resources to expand to meet increased demand. Yet a reward structure, decentralization, and the budget machinery described are foreign to the pure public sector, and even if available might tend to look too much like the for-profit system to meet our needs.

5. Cooperative Forms

Providing day care under the family-like regime of cooperation would seem to meet the objections to for-profit and public provision. It would seem that a community might get together to provide care for its children, partly by sharing the tasks, partly by paying workers (who might come from the community) from what the users earn. This would make day care more trustworthy, more what the parents want for their children. While physically this is practical (day care does not require extensive physical plant or training), organizational problems inherent in cooperative forms make it difficult in present day American society. In the cooperative, evaluation and adjustment are internal and not separate. The cooperative must function as a team, which is extremely difficult in large special purpose organizations.⁶⁸ Cooperatives are hard to organize. Since the arrangements are not preestablished, who does what, when, for whom, and with what compensation must be worked out in advance. Cooperatives tend to be cumbersome, and the change when old participants move or new ones join requires a whole new arrangement. They face the free rider problem, the slacking off of their responsibilities by some of the members, and all this makes them very unstable.

Since the day care needs of working women are not likely to be symmetrical, the cooperative will end up divided into day care users, and day care providers. In a kibbutz-like setup, the users would pay their "debt" to the collective by other jobs within it, but in a pure day care cooperative, money compensation no doubt will be required. This is more necessary if the day care is to be reliable and always available. While cooperatives may work out in some cases, they cannot be relied upon as the central organizing principle for a national system of extra-family day care.

6. Nonprofit Centers

Nonprofit firms, as opposed to firms that fail to make profits, spring up when an individual perceives a community need and offers to fill it without attempting to show a profit, generally because he considers the service to be worthwhile and enjoys providing it.⁶⁹ Nonprofit day-care centers are decentralized and subject to consumer preference, yet

⁶⁸ The Israeli Kibbutzim are general purpose organizations, so that specific tasks can be imbedded in more general relationships, and widespread "trading" of responsibilities is possible.

⁶⁹ The nonprofit manager may attempt to take in high salary what would normally be called profits and thus escape rules against profitmaking. This may be a problem. It could be at least partially controlled by strict Government ceilings on the salaries that may be paid for certain functions in the center. The openness that we will demand of nonprofit day care centers will make this kind of overview straightforward.

aim at providing good care, having no incentive to gain at the expense of the consumer. Unfortunately, such a regime lacks the traditional adjustment mechanisms of the free enterprise system. While, if demand disappears the center will too, the nonprofit firm does not expand to meet excess demand, since it is usually set up to provide a particular amount of day care, and the manager-owner usually is not prepared to set up franchises he cannot personally control. Good day care centers, faced with excess demand, tend to expand not their facilities but their waiting lists.

Still the nonprofit form is an attractive one for day care. Since no public agency runs the centers, they can respond quickly in a decentralized manner to consumer needs, and avoid the monopoly of public enterprise. And with each center organized by paid decision-makers with a paid work force, the instability of cooperative forms is avoided. And since centers aim at good care, subject to financial viability, they are open and responsive to parents.

What is needed is some mechanism to allocate and shift resources for good day care.

7. New Forms of Organization

It is also useful to consider new ways of organizing work and day care so as to reduce the high cost of child care to the working mother. Some firms (for example KLH, AVCO) have established day-care centers to serve their employees. If the working woman can bring her children with her to work, we are able to economize both on transportation to the day-care center and the amount of time the child must spend away from the mother. We can speculate on other organizational innovations that might make work for poor mothers more feasible.

We might attempt to alter the nature of the work itself. Firms might be encouraged to hire two mothers to fill one job. The mothers could then alternate on the job, with the one not working taking care of both families' children. This would be a working cooperative. Depending on the job, the mothers could switch off every month, week, or even day. On simple jobs, one mother could work mornings, the other afternoons. We might also combine this with day care provided at work. The mothers themselves could alternate between their jobs and working in the day-care center.

It may also be possible to develop work that could be done part time in the home. Child care would then be a joint output with this work, just as it is with normal housework. This remains, however, pure speculation. Income maintenance proposals have concentrated on the more usual forms of day-care arrangements.

8. A Practical Proposal

While there would seem to be some preference for nonprofit day care, the reality is that we will have to accept some mix in the industry. If work for mothers is strongly encouraged or required, day care will be needed to an increased extent and with a new flexibility in supply unobtainable under a pure nonprofit regime. Public provision may be needed in some areas, and private entrepreneurs might effectively fill shifting gaps in any scheme. The real problem is public control and this should be dealt with separately and directly.

Good consumer choice depends on parents being able to make informed judgments. Public policy, besides regulating physical safety, must attempt to improve parental information. Day care centers might be required to detail the types of programs they offer and the resources they have available, subject to checks by the regulatory agency. Public experts might be called on to write up critiques of the centers' goals and methods. Above all, centers must operate in a fish bowl, open to parental overview at all times, with opportunities for parents to interact with those running the centers. This interaction would enable day-care centers to meet parental needs, since it is clear that frequent shifting of children between centers is undesirable from a developmental point of view. Still, tastes and needs vary and there is no need for all centers to be identical.

Nonprofit firms might be favored, or even actively encouraged. Under most antipoverty schemes, we expect to have large numbers of mothers available for work. The Federal Government might assist groups of these women in establishing community nonprofit centers (nonprofit, of course, only after a fair wage to the mothers). Federal services, provided at cost, could help keep expenses down by realizing economies of scale. For example, capital goods needed for a day-care center could be rented, thus cutting the capital risks involved. Food could be bought in bulk and maybe precooked for warming at the centers. Federal experts could circulate to provide training and supervision, again at cost. This would allow day care to be set up quickly and efficiently. In fact, the entire package could be precosted to allow groups to quickly investigate the opportunities for establishing a center, and Federal business experts could help the future center organizers accurately gauge demand.

Such schemes, combining the best aspects of centralized planning and decentralized adjustment, offer the best hope for a rapid expansion of day care. It is clear that for the Federal Government to take on sole responsibility for providing day care would call for a tremendous direct investment in the industry. By encouraging local organization, not only is the expenditure reduced, but the goal of decentralization would be served.

In any system not primarily dependent on private, for-profit day care, some central planning organization will be needed to insure the proper allocation of resources. Such an organization would gauge where an expansion in day care facilities was needed and act to insure that such an expansion took place. As a last resort, the organization would be expected to provide the day care itself, but it is expected first to encourage nonprofit groups to enter the market, perhaps via the Federal "packages" discussed above.

Supplement 1. Descriptive Extension of Table 5

(1) This is the case of no day care and no labor force participation.

(2) If there is no deduction for day care, then the net benefits are $G-t(W-D)$, providing $W \geq D$ (which we assume here). Therefore

$$\begin{aligned} Y_a &= G - t(W - D) + W - C \\ &= G + tD + (1 - t)W - C \end{aligned}$$

To obtain t_e and MC_c we need simply note that

$$1 - t_e = \frac{dY^a}{dW}$$

and

$$MC_c = \frac{dY}{dC}$$

(3) If there is deduction allowed up to C_o , then if $C \leq C_o$, the net benefit is $G - t(W - D - C)$ and

$$\begin{aligned} Y^a &= G - t(W - D - C) + W - C \\ &= G + tD + (1 - t)(W - C) \end{aligned}$$

If $C \geq C_o$, the total deduction is limited to C_o , and the net benefit is $G - t(W - D - C_o)$ and

$$\begin{aligned} Y^a &= G - t(W - D - C_o) + W - C \\ &= G + tD + (1 - t)W - (C - tC_o) \end{aligned}$$

(4) If there is a full subsidy on the *first* $C_s - f(W)$ dollars of day care, then as long as $C \leq C_s - f(W)$, there will be no day care cost to the family and

$$\begin{aligned} Y^a &= G - t(W - D) + W \\ &= G + tD + (1 - t)W \end{aligned}$$

(note that $C \leq C_s - f(W)$ is the same as $f(W) \leq C_s - C$). When $C > C_s - f(W)$; that is, $f(W) > C_s - C$, then the family still receives the subsidy for day care of $C_s - f(W)$, if $C_s < f(W)$, but must pay the remainder (deductible) for day care of $C - [C_s - f(W)]$ and the benefit is

$$G - t\{W - D - [C - C_s + f(W)]\}$$

Thus

$$\begin{aligned} Y^a &= G - t\{W - D - [C - C_s + f(W)]\} + W - [C - C_s + f(W)] \\ &= G + tD + (1 - t)\{W - [C - C_s + f(W)]\} \end{aligned}$$

Finally, when $f(W) > C_s$, there is no subsidy, and

$$Y^a = G + tD + (1 - t)(W - C)$$

as in (3).

(5) If there is a full subsidy on the last $C_s - f(W)$ of day care, up to the total of C_s on day care, then if $f(W) \geq C$, then there will be no subsidy, and $Y^a = G + tD + (1 - t)(W - C)$ as in (3).

If $f(W) < C$ ($C_s > C$), the subsidy is $C - f(W)$, and the parent pays $f(W)$ for care; therefore, the benefit is $G - t[W - D - f(W)]$, and

$$\begin{aligned} Y^a &= G - t[W - D - f(W)] + W - f(W) \\ &= G + tD + (1 - t)[W - f(W)] \end{aligned}$$

Case 2.—Deduction, \$2,200 limit

C	W →	0	720	1000	2000	3000	4000	5000	8000	
		2800	3520	3613	3947	4280	4613	4947	5947	
600		2600	3320	3413	3747	4080	4413	4747	5747	
1200		2400	3120	3213	3547	3880	4213	4547	5547	
1800		2200	2920	3013	3347	3680	4013	4347	5347	
2200		2067	2767	2880	3213	3547	3880	4213	5213	↑ $MC_c = 1/3$ ↓ $MC_c = 1$
2400		1967	2587	2680	3013	3347	3680	4013	4613	
3000		1267	1987	2080	2413	2747	3080	3413	4013	
3600		667	1387	1480	1813	2147	2480	2813	3413	

$t_e = 0$ ← → $t_e = 2/3$

Case 3.—Subsidy on first $C_s f(W)$ dollars, deductibility of all parent expenses up to C_s total on care by all parties

$C_S=3000, f(W)=0.6$										
C	W →	0	720	1000	2000	3000	4000	5000	8000	
		2800	3520	3613	3947	4280	4613	4947	5947	
600		2800	3520	3613	3947	4280	4613	4747	5747	
1200		2800	3520	3613	3947	4280	4413	4547	5547	
1800		2800	3520	3613	3947	4080	4213	4347	5347	
2400		2800	3520	3613	3747	3880	4013	4147	5147	
3000		2800	3376	3413	3547	3680	3813	3947	4947	$\uparrow MC_C = \text{see below}$ $\downarrow MC_C = 1$
3600		2800	2776	2813	2947	3080	3213	3347	4347	

$t_e = \text{see below}$ ← → $t_e = 2/3$

For W between 0 and 720, $t_e = 0$ above the diagonal line, and $t_e = (1-t)f' = 0.2$ below the diagonal; for W between 720 and 5000, $t_e = \frac{2}{3}$ above the diagonal and $t_e = t + (1-t)f' = \frac{1}{3}$ below it. For C less than 3000, $MC_c = 0$ above the diagonal and $MC_c = \frac{1}{3}$ below it.

Case 4.—Parent's pay first $f(W)$ dollars of care (deductible); subsidy on the next $C_s - f(W)$ dollars of day care expenses; expenses beyond C_s not deductible

$C_s = 3000, f(W) = 0.6$										
C	W →	0	720	1000	2000	3000	4000	5000	8000	
		2800	3520	3613	3947	4280	4613	4947	5947	
600		2800	3374	3413	3747	4080	4413	4747	5747	
1200		2800	3374	3413	3547	3880	4213	4547	5547	
1800		2800	3374	3413	3547	3680	4013	4347	5347	
2400		2800	3374	3413	3547	3680	3813	4147	5147	
3000		2800	3374	3413	3547	3680	3813	3947	4947	↑ $MC_c = \text{see below}$ ↓ $MC_c = 1$
3600		2200	2774	2813	2947	3080	3213	3347	4347	

$t_e = \text{see below}$ ← → $t_e = 2/3$

For W between 0 and 720, $t_e = 0$ above the diagonal line, and $t_e = (1-t)f' = 0.2$ below the diagonal; for W between 720 and 5000, $t_e = \frac{2}{3}$ above the diagonal and $t_e = t + (1-t)f' = \frac{1}{3}$ below it. For C less than 3000, $MC_c = \frac{1}{3}$ above the diagonal and $MC_c = 0$ below it.

Case 5.—Proportional subsidy of $C_s - f(W)/C_s$ on each of the first C_s dollars of day care, deductibility of the proportion paid for by parents, no deduction of expenses beyond this

$$C_s = 3000, f(W) = 0.6$$

C	$W \rightarrow$	0	720	1000	2000	3000	4000	5000	8000
0	2800	3520	3613	3947	4280	4613	4947	5947	
600	2800	3491	3573	3867	4160	4453	4747	5747	
1200	2800	3462	3533	3787	4040	4293	4547	5547	
1800	2800	3434	3493	3707	3920	4133	4347	5347	
2400	2800	3405	3453	3627	3800	3973	4147	5147	
3000	2800	3376	3413	3547	3580	3813	3947	4947	
3600	2200	2776	2813	2947	3080	3213	3347	4347	

$MC_c = \text{see below}$

$MC_c = 1$

$t_e = (1-t) \frac{f'(C)}{C_s}$
 $= 0.2 \frac{C}{C_s} \text{ (see below)}$

$t_e = t + (1-t) \frac{f'(C)}{C_s}$
 $= 2/3 + 0.2 \frac{C}{C_s} \text{ (see below)}$

$t_e = 2/3$

For C less than 3,000 and W less than 5,000, $MC_c = (1-t) \frac{f(W)}{C_s}$. Several values for (W, MC_c) in this range are as follows: (0, 0); (1000, 1/15); (2000, 2/15); (3000, 1/5); (5000, 1/3). For C less than 3000 and W greater than 5000, $MC_c = 1/3$.

For W between 720 and 5000, $t_e = t + (1-t) \frac{f'(C)}{C_s}$ as long as C is less than 3000. Some values for (C, t_e) in this range are as follows: (0, 2/3); (600, 53/75); (1200, 56/75); (1800, 59/75); (3000, 65/75) or (3000, 13/15).

For C greater than 3000 and W between 720 and 5000, $t_e = 13/15$. For W less than 720, $t_e = 0.2 \frac{C}{C_s}$ for C less than 3000; above 3000, $t_e = 0.2$.

Supplement 4. Costs of Day Care for Mothers in Training

(1) Among mothers with children ages 6 and 14 only, who do not now work more than $\frac{1}{2}$ year, there are 1,429,000 children.

Among mothers with children both between ages 6 and 14 and 3 and 5, who do not now work more than $\frac{1}{2}$ year, there are 420,500 children 3-5 and 575,500 children 6-14.

Maximum estimate, using figures with 20 percent inflation (tables 3 and 4):

420,500 children \times \$2,052	\$ 862,866,000
1,849,500 children \times \$718	1,327,941,000
Total	<u>2,190,807,000</u>

Minimum estimate, using figures with 20 percent inflation (tables 3 and 4):

420,500 children \times \$1,344	\$ 565,152,000
1,849,500 children \times \$372	688,014,000
Total	<u>1,253,166,000</u>

(2) Consider the families in (1) with preschoolers—

In 1 year, of the 420,500 children age 3-5, a third (140,167) will be in school; of the 575,500 children age 6-14, a ninth (63,944) will be over 14.

Over the situation in (1), we now save $63,944 \times$ care for children aged 6-14 plus $140,167 \times$ (care for children aged 3-5 minus care for children 6-14):

Maximum estimate:

63,944 × \$718.....	\$ 45, 912, 111
140,167 × \$1334.....	186, 982, 333
Total.....	<u>232, 894, 444</u>

Minimum estimate:

63,944 × \$372.....	\$ 23, 787, 333
140,167 × \$972.....	136, 242, 000
Total.....	<u>160, 029, 333</u>

(3) Consider now the families with children under 3 years old: in these families there are 742,000 children under 3; 389,000 children between 3 and 5; and 963,500 children between 6 and 14; if we consider those families with a mother who will need training (that is, who does not now work more than $\frac{1}{2}$ year).

Those children under 3 will enter the range of 3-5 evenly over the next 3 years; thus, on the average, $\frac{1}{2}$ of the children 3-5 will be over 6 when this occurs (and the mother takes training), and $\frac{1}{6}$ of those 6-14 will be over 14 when the mother takes training.

Thus, 742,000 children now aged 0-2 become 742,000 children aged 3-5; the 389,000 children now aged 3-5 become 194,500 children aged 3-5 and 194,500 children aged 6-14; and the 963,500 children now aged 6-14 become 802,917 children aged 6-14 and 160,583 children over age 14.

Maximum estimate:

936,500 children × \$2,052.....	\$1, 921, 698, 000
997,417 children × \$718.....	716, 145, 406
Total.....	<u>2, 637, 843, 406</u>

Minimum estimate:

936,500 children × \$1,344.....	1, 258, 656, 000
997,417 children × \$372.....	371, 039, 124
Total.....	<u>1, 629, 695, 124</u>

(4) Estimate on total cost of child care for mothers in training:

Maximum estimate:

(\$2.19 billion - \$0.23 billion) + \$2.64 billion = \$4.60 billion.

Minimum estimate:

(\$1.25 billion - \$0.16 billion) + \$1.63 billion = \$2.72 billion.

Note that these expenses will be spread over 3 years. We assume that no more children are born to mothers with children under age 3.

CURRENT PUBLIC ASSISTANCE BENEFITS AND AN ASSESSMENT OF STATE SUPPLEMENTATION UNDER PROPOSED FEDERAL ALTERNATIVES

By IRENE LURIE*

SUMMARY AND INTRODUCTION

Public assistance has traditionally been a function of State and local governments. The Social Security Act of 1935, which established public assistance (PA), provided that welfare would continue to be a State program. The act provides that the Federal Government make matching grants to the States, and in turn requires that the State programs conform to numerous rules and regulations. As a result of these regulations, the States' programs are similar in many respects although enormous diversity exists. Most importantly, the regulations leave the States with the complete authority for setting the level of benefits paid under their programs. No Federal statutes impose or even suggest a minimum or maximum dollar amount for the payments given recipients, and payments for persons in similar circumstances vary considerably from State to State.¹ The recognition that the welfare system is inequitable and creates incentives for family breakup, migration, and decreased work effort, plus the rapid increase in welfare costs, has created pressure for welfare reform.

A number of alternative plans designed to solve these problems have been proposed. A Federal system paying uniform benefits has wide appeal as a way to end the inequity of these interstate differentials and to relieve the States of the financial burden imposed by the current system. But the existence of differentials in payment levels complicates the establishment of a uniform Federal payment. A basic Federal payment equal to the highest payment now made by any State would not only be very costly, but could have labor market implications for the States with lower wage levels. A lower Federal payment would leave some welfare recipients worse off if States do not provide supplementary benefits, and this prospect has not proved appealing either. In 1971, when the Department of Agriculture issued

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¹ H.R. 1, as passed by the House and Senate and signed by the President on Oct. 30, 1972, provides for a federally administered program of assistance to the aged, blind, and disabled, with optional State supplements, to be effective January 1974. The program, to be known as supplemental security income for the aged, blind, and disabled will replace the present State administered programs which aid aged, blind, and disabled persons. The proposals for reform of the aid to families with dependent children (AFDC) program were not included in the final bill. This paper refers only to current programs for the aged, blind, and disabled, and not to the supplemental security income program.

regulations that would have cut food stamp benefits for some current participants, pressure from Congress and State Governors forced the Department to reverse itself. Attempts to cut welfare benefits are likely to meet similar resistance.

The solution proposed in H.R. 1 as passed by the House of Representatives in June 1971, and in the Senate Finance Committee's version of H.R. 1 of June 1972, is to permit the States to supplement a uniform Federal payment and to give them financial support under certain conditions. While supplementation avoids the above problems, it also would preserve much of the interstate differentials, whose reduction or elimination is a primary objective of welfare reform. Supplementation provisions of H.R. 1 also reintroduce other undesirable features of the present welfare system, such as the incentive for families to break up, or to migrate, and the potential for inequities resulting from administrative discretion.

The question to be discussed in this paper is whether interstate differentials in welfare benefits are justified on other than political grounds, and whether and how the Federal Government should provide for them.

The first section begins with a detailed description of how payment levels and tax rates are computed under the current public assistance programs. These payment levels and tax rates are compared with payment levels and tax rates under H.R. 1 (used hereinafter to refer to the version passed by the House in 1971 and known popularly as the family assistance plan), the Senate Finance Committee plan, and a universal demogrant plan paying \$1,200 per year to adults and \$600 to children. This comparison gives an idea of the supplementation that would be required to keep welfare recipients as well off under these three programs as they are now.² In July 1971, the largest amount paid to an AFDC family of four with no countable income was greater than the \$200 a month which would be paid under H.R. 1 in 30 States. The demogrant of \$250 a month for a mother and three children would leave fewer AFDC families with lower incomes: the maximum amount paid by AFDC for a family of four was greater than the demogrant in only 21 States. The adult welfare recipients would fare better under H.R. 1 than under the demogrant. The largest amount paid to recipients in the adult categories was greater than the \$150 monthly payment proposed by H.R. 1 for 1975 in two-fifths of the States. The largest amount paid to these categories is greater than the demogrant of \$100 a month in four-fifths of the States. The public employment program in the Senate Finance Committee proposal would pay a maximum of \$200 a month, less than AFDC payments to a family of four with no income in 30 States.

Comparing benefits received under the current and proposed programs becomes more complicated when recipients have income. The differences can be summarized by the income levels at which payments become zero. These levels, called breakeven points, are calculated under certain assumptions concerning sources of income and permitted deductions from income. The breakeven point in AFDC is higher than what would apply under H.R. 1 in 46 States, but it is always less than the \$750 monthly breakeven point (for a woman and three children)

² A description of these three plans is contained in the introduction to this volume.

of the demogrant analyzed here. In all States the breakeven points in OAA and APTD are lower than under H.R. 1 and the demogrant. The breakeven point for AB was greater than under H.R. 1 in 26 States and greater than the demogrant breakeven point in all States. Under the Senate Finance Committee proposal, families with earnings would be eligible for a wage subsidy and/or an earnings bonus. It is difficult to generalize about the differences in benefits under this scheme, since they depend on a complicated relationship between family members' wage rates, earnings, and AFDC benefit levels.

The second section presents the arguments for and against supplementation, and discusses the forms it might take to meet various objectives. One cost of State supplementation is the undesirable migration which might occur as a result of the differences in welfare benefits between areas. Evidence on the effect of welfare benefits on migration is examined, and it is concluded that policies which result in regional differences in benefits should be developed with recognition of their influence on migration.

Three arguments in favor of supplementation are examined. Supplementation to adjust for area cost-of-living differences is appropriate if the objective of the Federal program is to guarantee a minimum real income. However, because it is difficult to develop a good cost-of-living index, a price index is preferable for this purpose. Whether accurate adjustments for price differentials is worth the migration that might result is not decided.

Supplementation by States to help recipients adjust gradually to the lower Federal benefit level is appropriate. If Federal funds are given to the States to help finance this temporary supplementation, they should be in the form of block grants rather than matching grants. Supplementation on a permanent basis by States which desire to have higher benefits than those provided by the Federal program should not be prohibited. Whether Federal funds should be given to the States for this purpose cannot be determined a priori, but depends on the Federal Government's objectives regarding the distribution of income and population.

PAYMENTS UNDER THE CURRENT AND PROPOSED PROGRAMS

Under the current public assistance programs, a person or family which fulfills the noneconomic eligibility requirements for old age assistance (OAA), aid to the blind (AB), aid to the permanently and totally disabled (APTD), or aid to families with dependent children (AFDC) is eligible for assistance if its "countable income" is less than the State's "cost standard," the amount of money the State decides an individual or family needs. For each of these programs, States establish cost standards which vary according to the size of the family and, in some States, the age and sex of its members. The welfare payment is equal to all or part of the difference between countable income and the cost standard, or some fraction of the cost standard.

In each State, costs for "basic needs"—food, shelter, clothing, and utilities—are computed and the sum of these amounts becomes the "cost standard." Many States also recognize "special needs," such as special diets and transportation expenses, that arise for people in specified circumstances. Determination of which items are considered to be "basic" and which are "special" varies from State to State; for

example, some States consider a telephone to be a basic need while others call it a special need. The Department of Health, Education, and Welfare regularly collects and publishes data on cost standards for basic needs, but not on special needs.³ The data on payment levels presented below will, therefore, include only basic needs. One should keep in mind that the payments in some States will be higher for certain recipients who have special needs.

"Countable income" is income from all sources less specified amounts of "disregarded income." Some income is disregarded in order to take account of unusual demands on recipients' income. For example, some families can deduct income that goes to support people outside the assistance unit and income that is used to buy items not included in the cost standard. Each month the programs disregard certain amounts of earnings completely and a fraction of earnings above these amounts to provide an incentive for recipients to work. Under the AFDC program, States are required to disregard the first \$30 of monthly earnings plus one-third of the remainder. For the blind, States are required to disregard the first \$85 of monthly earnings plus one-half of the remainder. For the aged and disabled, States are permitted, but not required, to disregard up to \$20 of the first \$80 of monthly earnings and one-half of the remainder. Additional income of the blind and disabled can be disregarded for a limited period of time if the individual has a plan for achieving self-support. Work expenses are deductible, as are the earnings of children in school.

Some States pay recipients the entire difference between the cost standard and countable income. Others limit the payment by paying only a maximum amount regardless of the recipients' need. Others apply a "percentage reduction," i.e., they pay a percentage of the difference between the cost standard and countable income.

Some States reduce the cost standard itself and pay the difference between countable income and the reduced standard. Widespread use of a reduced standard followed the 1967 welfare amendments which required that States increase their AFDC cost standards to adjust for increases in the cost of living. The Supreme Court interpreted the requirement to mean that States must increase the standard used to determine eligibility for AFDC but not the standard used to determine the AFDC payment. As a result of this decision, about half the States now compute the AFDC payment as the difference between countable income and some percentage of the cost standard. A new term, "payment standard," is now used to describe the standard against which income is compared to determine the payment. The payment standard is the cost standard in States which use the full standard; it is the reduced standard in States which have reduced the standard by some percentage. Some States have also started to use

³ HEW asks States to report recurring special-need items which would apply to more than half of the caseload, but the data obtained are too imprecise to publish. According to the unpublished data, in July 1971, 16 States reported special-need items in OAA and APTD, 23 in AB, and 13 in AFDC. The median amount reported was \$8 in OAA, \$10 for a family of four in AFDC, and \$11 in AB. Money given for purchase of furniture and household appliances and equipment is not reported as a recurring special need. In 1969, 30 States had some provision for these needs. In an HEW survey of characteristics of adult category recipients in 1970, one-half of OAA recipients were reported to have special needs included in the OAA payment at an average monthly amount of \$18.49; 55 percent of AB recipients at an average of \$24.20; and 40 percent of APTD recipients at an average of \$17.91.

a reduced standard in AB, OAA, and APTD to determine both eligibility and payments.

Public Assistance Payments to Recipients With No Income

The payment standards for basic needs for July 1971 are shown in table 1.⁴ In States which do not limit payments by maximums or a percentage reduction, the payment standard represents the payment that would be given to a family with no countable income. In States which do limit payments, families with no countable income would receive the amount in the column "largest amount paid." In States which recognize special needs, some families would receive more than the amount shown in the table. Families paying rents below the maximum permitted would receive less.

The welfare payments made to persons with no income vary widely from one State to another. In the adult categories, monthly payments to a single person range from about \$66 to \$250. For an AFDC family of four, they vary between \$60 and \$372.

⁴ Most States do not establish standards for shelter costs, but rather pay a person or family according to the shelter costs actually incurred, up to a maximum. The payment standards published by HEW and used in table 1 are, in general, for persons or families living alone in rented quarters and paying the maximum rent. Payment standards are lower for families paying less than the maximum, for those sharing quarters with other persons, for most homeowners, and for those with free housing. Cost standards for basic needs do not usually apply to aged, blind, or disabled recipients who are unable to live alone or with relatives and require care in boarding homes or other nonmedical residential facilities. Payments for such care are often higher than reported cost standards, which are based on ordinary personal and household expenses.

TABLE 1.—*Monthly income guarantees and breakeven points in public assistance, July 1971, compared to H.R. 1 and a demogrant plan*

	Old age assistance (1 person)			Aid to the blind (1 person)			Aid to the permanently and totally disabled (1 person)			Aid to families with dependent children (family of 4)		
	Payment standard	Largest amount paid	Break even point ¹	Payment standard	Largest amount paid	Break even point ¹	Payment standard	Largest amount paid	Break even point ¹	Payment standard	Largest amount paid	Break even point ¹
H.R. 1.....	\$150		\$360	\$150		¹ \$425	\$150		\$385	\$200		\$360
Demogrant plan, 1/3 tax rate, \$100 per adult, \$50 per child.....	100		300	100		300	100		300	250		750
Present public assistance programs:												
Alabama.....	146	\$103	166	105	\$85	² ⁸ 350	71		91	81		242
Alaska.....	250		270	250		625	250		270	400	\$372	¹⁰ 720
Arizona.....	118		² 146	118		² 376	118		138	256	167	⁸ ¹⁰ 512
Arkansas.....	109	105	⁴ 179	109	105	343	109	\$105	⁴ 179	229	111	464
California.....	178		⁴ 248	192		² ⁸ 524	172		⁴ 242	274	261	531
Colorado.....	140		⁴ 210	105		335	123		⁴ 193	242		483
Connecticut.....	169		⁴ 239	169		463	169		⁴ 239	327		⁹ 610
Delaware.....	140		³ ⁴ 215	189		² 518	117		³ ⁴ 192	287	172	³ 558
District of Columbia.....	153		² ⁴ 230	153		² ⁸ 231	153		² ⁴ ⁸ 231	239		⁸ ¹⁰ 486
Florida.....	114		⁴ 184	114		353	114		⁹ 134	223	134	454
Georgia.....	105	91	³ ⁴ 180	105	91	³ ⁸ 445	105	91	³ ⁴ 180	227	149	460
Hawaii.....	132		² ⁴ 210	132		² 404	132		² ⁴ 210	271		³ 534
Idaho.....	163		² 191	163		² 466	163		² 191	241		³ 489
Illinois.....	169		⁴ 239	169		463	169		⁴ 239	272		528
Indiana.....	185	100	² 213	185	125	² 510	185	80	² 213	363	205	³ ¹⁰ 673
Iowa.....	117		⁴ 187	144		³ 423	117		⁴ 187	300	243	570
Kansas.....	203		⁴ 273	203		531	203		⁴ 273	321		¹⁰ 602
Kentucky.....	96		² ⁴ 174	96		² 332	96		² ⁴ 174	234	171	¹⁰ 471
Louisiana.....	143	100	⁴ 213	106	101	⁸ 337	95	66	⁴ ⁸ 165	104		276
Maine.....	123	115	² ⁴ 200	123	115	² 386	123	115	² ⁴ 200	349	168	¹⁰ 644
Maryland.....	96		⁶ 146	96		317	96		116	200		¹⁰ 420
Massachusetts.....	189		⁴ 259	180		² ⁸ 500	178		⁴ 248	349		¹⁰ 644
Michigan.....	224		244	224		⁸ 573	224		244	350		645
Minnesota.....	183		⁴ 253	183		⁸ 491	183		⁴ ⁸ 253	334		¹⁰ 621

Mississippi	150	75	² 178	150	75	² 440	150	75	² 178	277	60	536
Missouri	181	85	³ 236	250	90	² 635	170	80	³ 195	303	130	³ 582
Montana	111		² 178	111		² 362	111		² 188	206		¹⁰ 429
Nebraska	182		³ 260	182		² 504	182		² 260	347	226	³ 648
Nevada	170		³ 225	155		² 450				176		³ 392
New Hampshire	173		³ 248	173		² 481	173		³ 248	294		561
New Jersey	142		162	142		409	142		162	324		¹⁰ 606
New Mexico	116		136	116		⁸ 357	116		136	203	179	424
New York	159		² 186	159		² 458	159		² 186	336	313	624
North Carolina	112		132	120		365	112		132	159		¹⁰ 358
North Dakota	125		⁴ 195	125		375	125		⁴ 195	300		¹⁰ 570
Ohio	126		² 204	126		² 392	116		² 194	200		420
Oklahoma	130		⁴ 200	130		⁸ 385	130		⁴ 200	189		404
Oregon	122		² 180	163		² 466	122		² 150	279		¹⁰ 538
Pennsylvania	146		⁸ 196	150	105	⁸ 435	146		166	313		590
Rhode Island	163		⁴ 233	163		⁸ 451	163		⁴ 233	263		¹⁰ 514
South Carolina	87	80	³ 162	103	95	331	87	80	⁴ 157	198	103	417
South Dakota	180		⁸ 205	180		³ 495	180		³ 205	270		525
Tennessee	102	97	122	102	97	329	102	97	122	217	129	446
Texas	119		² 146	110		345	110	105	130	148		342
Utah	103		⁴ 173	113		351	103		⁴ 173	218		447
Vermont	177		⁸ 227	177		⁷ 479	177		⁶ 227	327		610
Virginia	152		⁷ 182	153		431	152		172	261		512
Washington	143		⁴ 213	143		⁸ 411	143		⁴ 213	286	274	¹⁰ 549
West Virginia	76		² 104	76		277	76		⁹ 96	138		327
Wisconsin	158		⁴ 228	158		441	158		⁴ 228	274		¹⁰ 531
Wyoming	139	104	² 166	139	104	³ 418	127	104	² 154	260	227	510

¹ All income is assumed to be earned income; families with unearned income will have lower breakeven points. In computing the breakeven points, work expenses were deducted from income. They were assumed to be \$20 for recipients in the adult categories and \$60 for AFDC recipients.

The following amounts, chosen at the option of the States, were deducted from income in computing the breakeven point:

² \$7.50 of income.

³ \$5.00 of income.

⁴ \$20 of earnings plus $\frac{1}{2}$ of the next \$60 of earnings.

⁵ \$20 of earnings plus $\frac{1}{2}$ of the next \$40 of earnings.

⁶ \$10 of earnings plus $\frac{1}{2}$ of the next \$40 of earnings.

⁷ \$10 of earnings.

In addition to the amounts disregarded in calculating the breakeven points, States report disregarding:

⁸ Income of an individual who has a plan for achieving self-support approved by the State welfare agency, for up to 3 years.

⁹ Income of an individual who has a plan for achieving self-support approved by the State welfare agency, for up to 1 year.

¹⁰ Income deducted for the future identifiable needs of a child, with each State stipulating the particular conditions under which income can be deducted.

Sources: U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, *Public Assistance Programs: Standards for Basic Needs*, July 1971. Report No. 72-08200, Mar. 20, 1972.

U.S. Department of Health, Education, and Welfare, *Characteristics of State Public Assistance Plans under the Social Security Act: General Provisions*, Public Assistance Report No. 50 (1970).

Public Assistance Payments to Recipients With Income

The computation of benefits received under the current programs becomes more complicated when recipients have income. Benefits are reduced as earned income increases, and the rate at which benefits are reduced, the implicit tax rate, depends on many characteristics of the State programs. In large part, the tax rate depends on the amount of income that is disregarded in determining the size of the payment.

Under aid to families with dependent children, a State with no maximum or percentage reduction would give recipients the following amount:

$$\begin{aligned} \text{monthly payment} = & \text{payment standard for basic needs} \\ & + \text{special needs} \\ & - [(Y_E - \$30) - \frac{1}{3}(Y_E - \$30) + Y_U - Y_D] \end{aligned} \quad (1)$$

where Y_E = income from earnings

Y_U = unearned income

Y_D = deductions other than the disregard of \$30 of earnings and one-third of the remainder.

In addition to the \$30 and one-third disregard of earnings, States are required to deduct: (1) expenses of earning income, including day care expenses; (2) earnings of children who are in school; and (3) incentive payments from the work incentive program. States have the option of deducting: (4) \$5 of income; (5) income set aside for the future needs of a child; (6) income allocated to expenses not included in the assistance budget; and (7) income assigned to support dependents outside the assistance unit. In all four PA programs, deductions in excess of income are ignored. That is, a family with deductions greater than income receives a payment equal to the payment standard plus their special needs and is not reimbursed for its excess deductions.

Under aid to the blind, a State with no maximum or percentage reduction would determine payments using the following rule:

$$\begin{aligned} \text{monthly payment} = & \text{payment standard for basic needs} \\ & + \text{special needs} \\ & - [(Y_E - \$85) - \frac{1}{2}(Y_E - \$85) + Y_U - Y_D] \end{aligned} \quad (2)$$

where Y_D = deductions other than the disregard of \$85 of earnings and one-half of the remainder.

In addition to this earnings disregard, States are required to deduct: (1) expenses of earning income; (2) \$4 of social security benefits; and (3) additional income of persons with a plan for achieving self-support, for up to 1 year. A State may deduct: (4) additional income of such a person for another two years; and (5) \$7.50 of income.

Under old age assistance and aid to the permanently disabled, States are given the option of deducting up to \$50 of earnings: the first \$20 and half of the next \$60. A State with no maximum or percentage reduction which does not choose the optional earnings disregard would determine the payment in this way:

$$\begin{aligned} \text{monthly payment} = & \text{payment standard for basic needs} \\ & + \text{special needs} \\ & - (Y_E + Y_U - Y_D). \end{aligned} \quad (3)$$

States are required to deduct: (1) expenses of earning income; and (2) \$4 of social security benefits. In addition to the earnings disregard, States have the option of deducting: (3) \$7.50 of income; and (4) for recipients of APTD, additional income of persons with a plan for achieving self-support, for a period of up to 3 years.

Many recipients of public assistance also receive food stamps, commodities, medicaid, and public housing. The bonus value of these in-kind transfers, that is, the difference between their face value and the price paid for them, is not counted as income in determining public assistance benefits.

Breakeven Points Under Public Assistance

As the income of welfare recipients increases, assistance payments are reduced or "taxed" away. Disregarding income reduces the implicit tax rate on income and increases the "breakeven point," the income level at which a recipient's payment falls to zero. If no income were disregarded, recipients paid the entire difference between the standard and gross income would have their payment reduced by \$1 for every dollar increase in their income. Their payments would equal zero when income equaled the standard.

For AFDC recipients, disregarding \$30 of earnings and one-third of the remainder results in a zero tax rate on the first \$30 of earnings and a 67-percent tax rate on the remainder. It can be seen from equation (1) that when the recipient has both earned and unearned income the AFDC payment equals zero (or income reaches the breakeven point) when

$$2/3Y_E + Y_U = \text{payment standard for basic needs} \\ + \text{special needs} + Y_D + \$20. \quad (4)$$

As can be seen from equation (4), the breakeven point depends not only on the total amount of income, but also on its composition. Disregarding \$30 of earnings and one-third of the remainder means that a recipient's payment becomes zero at a higher income level if his income is in the form of earnings than if it is unearned. If unearned income were zero, the breakeven point would be

$$Y_E = 3/2 (\text{payment standard for basic needs} \\ + \text{special needs} + Y_D + \$20). \quad (5)$$

If earned income were zero, the breakeven point would be

$$Y_U = \text{payment standard for basic needs} + \text{special needs} + Y_D. \quad (6)$$

For the adult programs, the breakeven point equation when earned income is zero is the same as under AFDC. When unearned income is zero, the breakeven points vary from one program to another.

For AB, the breakeven point can be seen from equation (2) to be

$$Y_E = 2 (\text{payment standard for basic needs} \\ + \text{special needs} + Y_D + \$42.50). \quad (7)$$

The breakeven point for a person receiving OAA or APTD with earned income only and living in a State which does not give the optional earnings disregard would be, from equation (3)

$$Y_E = \text{payment standard for basic needs} + \text{special needs} + Y_D. \quad (8)$$

In States which permit the maximum optional earnings disregard, the breakeven point would be \$50 higher.

These equations show the importance of disregards in lowering the tax rate and, consequently, increasing the breakeven point. The breakeven point in AFDC is increased by \$1.50 for every dollar increase in deductions, and the breakeven point in AB is increased by \$2. In OAA and APTD, a dollar deduction adds a dollar to the breakeven point.

While the Federal statutes and regulations described above give all States the same opportunity to disregard recipient's income, the deductions permitted vary considerably from State to State, from one welfare department to another, and undoubtedly from one caseworker to another. Work expenses, which States are required to deduct, can be defined in many different ways, from the relatively strict definition used in the Federal income tax, to one which includes lunch and street clothes. According to one expert, "Some proclient caseworkers take pride in generating enough expenses so that available income falls to zero."⁵ Federal law puts no limit on the income which can be set aside for the future identifiable needs of the child, and the amounts vary greatly. Similarly, deductions for other purposes can be made small or large, depending on the State, the caseworker, and the particular circumstances of the recipient. This is one of the main sources of horizontal inequity⁶ in the public assistance system.

Breakeven points calculated under specific assumptions concerning sources of income and amount of disregards are shown in table 1.⁷ In computing the breakevens, all income was assumed to be earned and all of the required disregards were taken into account.⁸ Work expenses were assumed to equal \$60 for AFDC families and \$20 for adult recipients. Optional disregards were taken into account only if

⁵ W. Joseph Heffernan, Jr., "Variations in Negative Tax Rates in Current Public Assistance Programs: An Example of Administrative Discretion," *Journal of Human Resources*, vol. 8, supp., 1973.

⁶ Horizontal inequity refers to unequal treatment of persons in similar circumstances.

⁷ In the adult categories, the payment standard is used to determine both eligibility of applicants and payments of recipients. The breakeven points shown in table 1 are, therefore, the levels at which people enter and exit the program. In AFDC, however, eligibility of people who are not receiving assistance or have not received it within the past 4 months is determined by comparing income *before* the \$30 and one-third disregard to the full cost standard. Only if they are eligible by this standard, can their income less *all* permitted disregards be compared to the *payment* standard to compute the payment. Even though the full cost standard is greater than the payment standard in about 20 States, the inability to claim the \$30 and one-third disregard in determining initial eligibility means that the point at which a family can initially become eligible for AFDC is lower than the point at which the benefit falls to zero.

⁸ Earnings of children in school and incentive payments from the work incentive program (WIN) were assumed to be zero. Additional income of an AB recipient who has a plan for achieving self-support was also assumed to be zero.

they were reported by HEW in its publication, *Characteristics of State Public Assistance Plans*.⁹¹⁰

The breakeven points facing families with unearned income only or with a combination of earned and unearned income will be lower than those shown in table 1. Families who pay less rent than is assumed in the payment levels published by HEW will also face lower breakeven points. On the other hand, families with special needs will have higher breakevens, as will families with greater disregards than were assumed in preparing the table.

The variation in breakeven points is quite large. AFDC breakeven points for a family of four ranged from \$242 a month in Alabama to \$720 a month in Alaska. There is less variation in the adult categories. In OAA, the breakeven points for a single recipient ranged from \$104 in West Virginia to \$273 in Kansas; in APTD from \$91 in Alabama to \$273 in Kansas; and in AB from \$277 in West Virginia to \$635 in Missouri.

Proposed Payments and Breakeven Points Under H.R. 1 as passed by the House of Representatives in June 1971

Under H.R. 1 a family of four would receive

$$\text{yearly payment} = \$2,400 - [Y_E - Y_{DE} - \$720] - \frac{1}{3}(Y_E - Y_{DE} - \$720) + Y_U - Y_X \quad (9)$$

where Y_{DE} = deductions that must be taken from earnings before the deduction of \$720 of earnings and one-third of the remainder
 Y_X = other disregarded income.

Y_{DE} includes: (1) child care expenses, but with upper limits set by HEW; (2) earnings of children in school, with upper limits set by HEW; and (3) irregular earned income of \$30 or less a quarter and irregular unearned income of \$60 or less a quarter. Y_X includes one-third of child support and alimony payments, training allowances of up to \$60 a month, assistance based on need (except veterans' pensions), and some additional less important amounts.

Some families would receive greater payments under H.R. 1 than under AFDC, while others would experience a loss if States do not

⁹ U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, Assistance Payments Administration, *Characteristics of State Public Assistance Plans Under the Social Security Act*, Public Assistance Report No. 50, (1970).

¹⁰ Some States permit disregards which are not reported in this publication. For example, the only optional disregards reported for AFDC families are the disregard of \$5 of income and the disregard of income set aside for the future identifiable needs of a child. But a survey of AFDC recipients in 1971 reported that about 3 percent of families claimed disregards for "expenses not included in the assistance budget" and "income assigned to support of other dependents." "Additional disregarded income," reported by 17 percent of the families in the survey, includes the \$5 disregard and the \$30 and one-third disregard taken into account in table 1, but also appears to include some other items which are not taken into account. U.S. Department of Health, Education, and Welfare, National Center for Social Statistics, *Findings of the 1971 AFDC Study, Part II. Financial Circumstances*, Report AFDC-2 (1971), table 71.

supplement the basic Federal payment at their current levels.¹¹ The following discussion explores the consequences of no State supplementation.

Generalizing about the difference in payments under AFDC and H.R. 1 is difficult: it depends on many factors, including the State in which a family is living, its size and composition, the amount and sources of its income, its special needs, and the disregards it has been permitted to claim. The procedure used here will be to compare payments made to families with no income, then compare the permitted disregards, and finally compare the programs' breakeven points calculated under certain assumptions. This will give some idea of the ranges of difference between payments made under the existing programs and under H.R. 1.

The AFDC payment to a family of four with no countable income is either the "payment standard" in table 1 or, in States with maximums or percentage reductions, the "largest amount paid." H.R. 1 would provide such a family with \$2,400 a year. The AFDC payment is higher than the \$200 a month which would be paid under H.R. 1 in 30 States, by an (unweighted) average of \$80. The importance of the difference depends, of course, on how many families have no income other than welfare: in 1971, 60 percent of AFDC families had no other income than welfare.

For many families with income, the provisions in H.R. 1 relating to deductions would have a greater effect in reducing payments below the current AFDC level than would the reduction in the basic benefit given to a family with no income. First, H.R. 1 allows fewer types of deductions than can be claimed by AFDC recipients. Most importantly, work expenses could not be deducted by these families. The increase in the 100-percent disregard from \$30 a month under AFDC to \$720 a year (\$60 a month) under H.R. 1 is designed to compensate recipients for the loss of the work expense deduction. But this minor liberalization would leave many working recipients worse off because the increase in the amount disregarded would be less than average work expenses. Second, H.R. 1 requires HEW to set limits on the deduction of day-care expenses and children's earnings, thereby reducing the amount and variability in deductions claimed by recipients. Third, it changes the order in which items must be deducted. HEW now requires that the \$30 and one-third disregard be deducted from earnings before any other items, including work expenses,¹² are deducted. The effect of this procedure is to reimburse recipients fully by an amount equal to the earnings which are disregarded. As shown in equation (5), it also has the effect of increasing the breakeven by \$1.50 for every dollar increase in disregarded earnings. Under H.R. 1, certain items must be deducted from earnings before \$720 and one-third of the remainder are deducted. The most important effect of this change would be that recipients will no longer be fully reimbursed for their entire day care expenditure but will only be reimbursed for two-thirds.

¹¹ The major extension in coverage would be to families headed by a working male, which are now ineligible for public assistance. Without intending to minimize this important liberalization, the focus here will be on the change in payments to families who are now eligible for public assistance.

¹² This means that the \$30 and one-third disregard of earnings is applied to gross, rather than net income. In contrast, a personal income tax applies the tax rate to income net of work expenses.

As a consequence of the fewer disregards permitted by H.R. 1, the tax rate for many AFDC recipients will increase and the breakeven level will fall. Some current AFDC recipients with nonwelfare income thus would incur a loss under H.R. 1. While some women currently ineligible for AFDC because their incomes are too high would be eligible for H.R. 1 benefits, the following discussion focuses on the potential loss which current recipients might face rather than the gain in equity for others currently excluded.

The breakeven point for a family of four under H.R. 1 as calculated from equation (9) is

$$\frac{2}{3} Y_E + Y_U = \$2,880 + \frac{2}{3} Y_{DE} + Y_X. \quad (10)$$

If unearned income, Y_X , and Y_{DE} are assumed to be zero, the breakeven point would be \$4,320, or \$360 a month.¹³ The breakeven points in AFDC shown in table 1 are greater than this in 46 States.

H.R. 1 would mean fewer changes in payments and breakeven points for recipients of OAA, AB, and APTD than for AFDC recipients. The most important change would be the replacement by 1975 of the widely varying State benefits with a uniform benefit of \$150 a month for a single person and \$200 for a couple. As shown in table 1, the public assistance payments made to adult recipients with no countable income are higher than the \$150 monthly payment under H.R. 1 in two-fifths of the States, by an (unweighted) average of \$28. The permitted deductions would be similar, although not identical, to those under current law. Blind persons could continue to disregard \$85 of earnings and one-half of the remainder, plus work expenses. The \$85 and one-half disregard would also be applied to the income of the disabled, although they would not be able to deduct work expenses. Aged persons would have their disregarded earnings level increased to \$60 and one-half of the remainder, but could not deduct work expenses. Limits would be placed on the amounts of some kinds of deductions permitted under the current law.

Under H.R. 1, the breakevens would be \$360 for the aged, \$385 for the disabled, and \$425 for the blind. This means that the breakevens under H.R. 1 would always be higher than the current OAA and APTD breakeven points. The breakeven point for the blind would be higher than the AB breakeven in 25 States.¹⁴

H.R. 1 would prohibit recipients in both the adult and family categories from participating in the food stamp program.¹⁵ Recipients

¹³ H.R. 1 provides for a minimum payment of \$10 per month. This would result in a breakeven point of \$4,140 in annual earnings, or \$345 per month. For illustrative purposes, the zero benefit breakeven point is used here.

¹⁴ The supplemental security income (SSI) program, effective January 1974, will have a benefit level of \$130 for a single person and \$195 for a couple. The first \$20 per month of income from any source will be disregarded. In addition, \$65 of earnings and one-half of the remainder will be disregarded for all recipients. (If all income is from earnings, the first \$85 and one-half of the remainder will be disregarded.) Work expenses of blind persons will continue to be disregarded. The breakeven levels will be \$385 for the aged and disabled, and \$425 for the blind.

¹⁵ SSI recipients will not be permitted to participate in the food stamp or commodity distribution programs. The bonus value of food stamps for a single person at the SSI benefit level of \$130 is \$10 per month. The average value of donated commodities per person is about \$13 per month. It is estimated that about 30 percent of current adult assistance recipients are in the food stamp program and about 15 percent receive commodities.

would lose the "bonus value" of food stamps, that is, the difference between their face value and the price paid for them.¹⁶ The bonus value decreases with income, since families are required to pay more for a given amount of stamps as their income, defined to include public assistance, increases. Table 2 indicates the bonus value per month of food stamps as determined in June 1972, for a single person and a family of four.

TABLE 2.—*Bonus value of food stamps, June 1972*

Monthly income	Single person	4-person family
\$0 to \$19.....	\$32	\$108
\$20 to \$29.....	31	108
\$30 to \$39.....	28	104
\$40 to \$49.....	26	101
\$50 to \$59.....	24	98
\$60 to \$69.....	22	95
\$70 to \$79.....	20	92
\$80 to \$89.....	18	89
\$90 to \$99.....	16	86
\$100 to \$109.....	14	83
\$110 to \$119.....	12	80
\$120 to \$129.....	10	77
\$130 to \$139.....	10	74
\$140 to \$149.....	10	71
\$150 to \$169.....	10	67
\$170 to \$189.....	10	61
\$190 to \$209.....	0	55
\$210 to \$229.....		49
\$230 to \$249.....		43
\$250 to \$269.....		37
\$270 to \$289.....		34
\$290 to \$309.....		30
\$310 to \$329.....		26
\$330 to \$359.....		26
\$360 to \$390.....		24

Source: Department of Agriculture.

Participation of welfare recipients in the food stamp program varies considerably from State to State. States are not required to have a program in each county, so that stamps are not available to all recipients. Not all eligible persons participate even in counties with a food stamp program because families may prefer to spend less on food than they are required to spend for the stamps, because they cannot accumulate enough cash to pay for the stamps, because they have difficulty picking up the stamps, or because they feel that stamps are humiliating. Data on the participation rate of AFDC recipients in the program in January 1971 are available for 20 States, and are presented in table 3.

¹⁶ States would be encouraged but not required to supplement the Federal benefit to make up for the loss of the food stamp bonus.

TABLE 3.—*Food stamp participation rate for AFDC recipients, January 1971*

<i>State</i>	<i>Percent participating</i>	<i>State</i>	<i>Percent participating</i>
Alabama.....	40	Mississippi.....	63
California.....	50	Missouri.....	34
Florida.....	8	New Jersey.....	41
Georgia.....	32	New York.....	82
Illinois.....	74	North Carolina.....	40
Kentucky.....	56	Ohio.....	79
Louisiana.....	74	Pennsylvania.....	52
Maryland.....	60	Tennessee.....	63
Massachusetts.....	5	Texas.....	29
Michigan.....	58	Washington.....	83

Source: U.S. Department of Health, Education, and Welfare, National Center for Social Statistics, *Findings of the 1971 AFDC Study, Part I. Demographic and Program Characteristics*, Report AFDC-2 (1971), table 40.

In States which do not supplement the Federal benefits to compensate for the loss of food stamp eligibility, some recipients will be considerably worse off. For example, a family of four whose only income is an AFDC payment of \$200 a month would continue to receive \$200 in cash under H.R. 1, but would lose \$55 in food stamp benefits.

Payments and Breakeven Points Under a Universal Demogrant Plan

Under a universal demogrant, everyone would receive a payment from the Federal Government regardless of his income. The payment could be the same for all persons or could vary by age and/or size of the family. The demogrant would be accompanied by a tax on income other than the grant. While the payment would not vary with income, the *net* payment after tax would decline as income became greater.

The demogrant considered here would pay adults \$1,200 a year and children \$600, and would tax income at a rate of one-third. The demogrant would replace public assistance, but could replace other income-related programs. Food stamps could be eliminated, while social security, veterans' programs, and housing programs need no longer have an antipoverty component, that is, need no longer be structured to provide special aid to the poor. These changes, of course, would have a major impact on low-income people other than welfare recipients and would raise problems besides the issue of the reduction in welfare benefits.

Under the demogrant, the typical AFDC family of four, a family of one adult and three children, would be paid

$$\text{yearly payment} = \$3,000 - \frac{1}{3} (\text{all income except the demogrant}). \quad (11)$$

The demogrant would replace current personal exemptions and deductions and the special low income allowance in the Federal income tax. The breakeven point would be at total income of \$9,000. A single adult would receive \$1,200 a year and would receive no net gain after taxes when his income reached \$3,600.

Among those whose sole source of income is public assistance, recipients of aid to the blind would suffer the largest drop in income

under this demogrant. The demogrant would be lower than the largest amount paid by AB in 42 States, and the demogrant break-even lower than the AB breakeven in every State except West Virginia. Many recipients of OAA and APTD would receive less if they had no other income, but the demogrant's breakeven would be greater than under OAA and APTD in all States. Recipients with relatively large amounts of other income would be better off under a demogrant. For example, many recipients of aid to the aged, blind, and disabled have social security income, and this income would be "taxed" only at a 33 percent rate rather than at 100 percent as is generally the case now. AFDC recipients would tend to be the best off under a demogrant. The largest amount paid by AFDC is greater than the demogrant in only 21 States, and the breakeven point for a family of four under AFDC is always lower than under the demogrant.

Benefits Under a Wage Subsidy-Public Employment Approach

The current public assistance programs, H.R. 1, and a universal demogrant plan have a similar benefit structure: a payment is made to people who have no income, and the net benefit declines at a specified rate as income increases. In contrast, a wage subsidy or public employment program would condition payments on the amount of work performed; the benefit from the program would generally increase with the amount of work effort or earnings. Wage subsidy payments would be calculated as some fraction of a person's earnings or some fraction of his wage rate multiplied by the number of hours he worked. A public employment program would provide people with jobs and, therefore, earnings.

The wage subsidy and public employment program considered here is the program for families with children contained in the welfare reform bill proposed by the Senate Finance Committee in June 1972. The committee's proposals concerning the adult public assistance categories have a similar benefit structure as the types of programs already analyzed—public assistance, H.R. 1, and the demogrant—and will not be discussed.

Under the committee's proposal, families with children would be divided into two groups according to their head's employability. The less employable group includes families headed by mothers with children under age 6 or by mothers who are ill, incapacitated, living in a geographically remote area, or attending school full time. They would continue to receive AFDC in much its current form. The major change for them would be a reduction in permitted disregards to a flat monthly exemption of \$20 a month and an additional disregard of \$20 of child support payments. While this is a significant change from the AFDC benefit structure, it would not cause a sharp decrease in payments for most of the families placed in this category. They are unlikely to work and so take advantage of the current disregards under AFDC, and if they do work they would be likely to place themselves voluntarily in the second category created by the committee's program.

The second category of families would be those with heads considered by the committee to be employable. This group would include families with children not eligible for AFDC under the new requirements: male-headed families and about 40 percent of current AFDC families. Three types of benefits would be offered to them and all

would be conditioned on employment: (1) The family head could take a public-employment job paying \$1.50 an hour for up to 32 hours per week;¹⁷ (2) if the head takes a regular job paying between \$1.50 and \$2 an hour, he or she would be paid a subsidy equal to three-quarters of the difference between the wage paid and \$2 an hour; and (3) workers in regular employment would receive an earnings bonus of 10 percent of the husband's and wife's combined earnings up to an earnings level of \$4,000, which would decline by 25 cents for each dollar of earnings above \$4,000.

How a family's benefit under this plan would compare with payments under AFDC, of course, depends on its earnings and which combination of these benefits it chooses. A family head working the maximum of 32 hours in public employment would obtain a total income of \$2,400 a year, or \$200 a month. A family head working full time in a regular job at \$1.50 an hour and receiving both the wage subsidy and the earnings bonus would obtain a total income of \$4,050 a year, or \$338 a month. If the job paid \$2 an hour, he would obtain a total income of \$4,400 a year, or \$367 a month. Table 1 can be used to compare these income levels to the AFDC payments given to families with no income. In 30 States public-employment earnings of \$200 a month would be less than AFDC payments to a family of four with no income. Total monthly income of a family whose head worked full time at \$1.50 an hour would be less than AFDC payments in three States, and at \$2 an hour would be less income than AFDC in only one State.

Comparisons with AFDC payments to families with earnings are more complicated and only one example will be given here. Assume that the cost standard for a family of four is \$270 per month, the median in 1971, and that a family has \$60 of work expenses. If the family head worked full time at \$1.50 an hour he would earn \$250 a month and receive \$183 in AFDC, for a total income of \$433. Under the committee plan, in comparison, the family would receive \$88 in subsidies for a total income of \$338. If the family head worked full time at \$2 an hour it would receive \$128 in AFDC, compared to subsidies of \$33 under the committee plan.¹⁸ In States with low AFDC benefits, however, an AFDC family with earnings would benefit under the committee plan.

One characteristic of the committee's proposal would cause some AFDC families to experience a particularly large drop in benefits: neither public employment earnings, the wage subsidy, nor the earnings bonus would be adjusted for family size. While it is possible that the benefits of an employment-conditioned transfer program could vary by family size, phasing out the variable benefits as earnings rise would increase the tax rate if the breakeven level is held constant.

¹⁷ The committee's proposal provides for public-employment wages at three-quarters of the Federal minimum wage and for supplementation of regular wages which are at least three-quarters of the minimum wage but are below the minimum wage. The illustration used by the committee is based on the assumption that the Federal minimum wage will be increased to \$2 per hour.

¹⁸ Here, as in comparisons of AFDC with H.R. 1, the impression should not be left that the benefits of these plans can be compared with precision. For example, child care would be subsidized to some extent under the committee plan. To the extent that working women required child care, their benefits under the committee's plan would be higher than those shown here and, therefore, would be closer to AFDC benefits.

Because the committee wanted to keep the breakeven level and the tax on earnings as low as possible, because it wanted payments to be related to work effort rather than need, and because it did not want to encourage families to have more children, it was willing to sacrifice the well-being of large families.¹⁹

Supplements To Prevent Recipients From Being Worse Off

When the Government considers reducing the benefits given to people, a furor usually results; and the debate on welfare reform is no exception. Several earlier versions of the family assistance plan, which eventually became H.R. 1, contained provisions which would require or permit States to supplement the Federal benefit so that no one would suffer a drop in income. What would be the consequence of taking this goal literally, of paying welfare recipients an amount which would exactly equal the difference between the new Federal payment and their previous public assistance benefit?

One problem is inherent in the goal paying families the exact difference between the new Federal payment and their previous welfare benefit. Because the sum of the Federal benefit and the supplement would equal the former welfare payment, the supplement would transform the Federal program back into public assistance. Undesirable features that the Federal program was designed to eliminate would be reintroduced through the supplement.

Another problem with this goal results from the wide variation in public assistance payments given to people with the same income. Determining the supplement which would equal the exact difference between payments under a new Federal program and former public assistance payments would be a very complicated process. For example, assume that a State's payment standard for basic needs for an AFDC family of four is \$300 and that the Federal Government or the State desires to supplement H.R. 1 benefits so that each family's total income would remain unchanged. Assume that family A has no special needs, work expenses, or other deductions. Family B has \$50 of special needs, \$60 of work expenses, and \$30 of income set aside for the future indentifiable needs of a child. Note the variations:

- (1) Monthly AFDC payment to A = payment standard — [earnings — \$30 — $\frac{1}{2}$ (earnings — \$30)]
= \$300 — $\frac{1}{2}$ (earnings — \$30).
- (2) Monthly AFDC payment to B = payment standard + special needs — [earnings — \$30 — $\frac{1}{2}$ (earnings — \$30) — work expenses — income set aside for future indentifiable needs of a child]
= \$300 + \$50 — [$\frac{1}{2}$ (earnings — \$30) — \$60 — \$30].
- (3) Monthly payment under H.R. 1 = \$200 — [earnings — \$60 — $\frac{1}{2}$ (earnings — \$60)]
= \$200 — $\frac{1}{2}$ (earnings — \$60).

If the Federal Government or the State were to supplement H.R. 1 benefits so that each family is exactly as well off as it was under AFDC, the supplements would vary with earnings as indicated in table 4.

¹⁹ The committee would permit State supplements to be related to family size.

TABLE 4.—*Supplements to H.R. 1 necessary to match AFDC payments to families A and B*

Monthly earnings	H. R. 1 payment	AFDC payment to family A	Supplement to family A	AFDC payment to family B	Supplement to family B
\$0	\$200	\$300	\$100	\$350	\$150
30	200	300	100	350	150
45	200	290	90	350	150
60	200	280	80	350	150
120	160	240	80	350	190
300	40	120	80	260	220
360	0	80	80	220	220
420	0	40	40	180	180
480	0	0	0	140	140
690	0	0	0	0	0

The difference in the supplements which would be given to the two families at each earnings level is substantial. Other families have different amounts of disregards and special needs determined on an individual family basis by a complex set of regulations and by caseworkers' discretion; thus, families would require different supplements. The administration of the supplement would be almost as complicated and time consuming as the administration of the current welfare programs.

This has several implications for the role of the Federal Government in State supplementation. The complexity of public assistance and the reliance on administrative discretion means that the Federal Government would have difficulty in determining how much in supplements would leave a family with certain characteristics as well off as now. It would have to learn the details of the existing State programs with regard both to the written rules and administrative practice. Obtaining accurate information on administrative practice would be an enormous, if not impossible, task. Procedures vary from one welfare agency to another, and the discretion allowed caseworkers means that they can also vary from one caseworker to another.

Given the difficulty of determining how much in supplements would leave families no worse off, the Federal Government should not attempt to supplement the uniform Federal benefit with this goal in mind. Nor should this goal be used in legislation relating to State supplementation of the Federal benefit. States should not be required to supplement up to the point where families are no worse off, nor should Federal financial assistance to the States depend on such a point. If the Federal Government were to give grants to the States based on leaving no family worse off, as has been required in some versions of the family assistance plan, it would not be able to tell whether States in fact were paying more or less than enough to keep recipients at their previous income level. The Federal Government would have to pay the bill but would have lost effective control. Federal requirements for State supplementation, if any, should use more clear-cut criteria.

CONSIDERATIONS FOR AND AGAINST INTERSTATE DIFFERENTIALS IN BENEFITS

The broader issue, which is the main focus of this paper, concerns the economic justifications for *any* interstate variation in welfare benefits. Welfare reform bills before the Congress have permitted States to supplement the Federal benefit; some bills even provided Federal financial assistance to the States for such supplementation. But these provisions have been the result of political compromise, not of reasoned analysis of their equity and economic efficiency. Supplements resolve the conflict between high benefit States whose recipients would receive less under the proposed alternatives discussed above and low benefit States which are reluctant to have a still higher level of Federal benefits than in these alternatives. Can such supplementation be justified on economic grounds?

The economic reasons why benefits should or should not vary from one plan to another will be discussed here, as well as the appropriate Federal policy toward such variation. Three arguments in favor of interarea differentials will be examined: Differentials to adjust to area cost of living differences; State supplements to allow for varying income redistribution preferences; and supplements to provide for individuals' special needs. The rationale for Federal financing will be considered in each case. The major argument against these three types of differentials is that they will create incentives for people to migrate. Unless this migration is desirable, it is a cost which must be balanced against the benefits resulting from the differentials.

Migration

Whether interarea differentials in welfare benefits stimulate migration to places where benefits are high is an empirical question. Circumstantial evidence suggests that interstate differentials in benefit levels do stimulate migration. The large-scale, postwar migration of blacks has been from low benefit States to more generous ones, and the high benefit States have experienced a large increase in their AFDC caseload. But, apart from this sort of argument, little is known about the effect of differentials on migration. How much do welfare differentials influence the decision to migrate? How important has migration, so motivated, been in increasing the caseload?

Economists now generally view migration as an investment in human capital. The decision to migrate is made by comparing the costs of migrating, both monetary and psychic, to the return obtained by migrating. The return is the change in a family's real income, where income includes not only earnings and income from property but transfer income, public services, climate, presence of friends, and other characteristics of a place which have positive value to a person or family. The return accrues over the future and, therefore, depends on the probability of receiving the various types of real income. The level of welfare benefits at a person's current and potential locations affects the return if he thinks that there is a probability of needing welfare at any time in the future. While some people may move with the explicit purpose of getting higher welfare benefits, knowing that there is a relatively good welfare program to fall back on can also affect the decision of a person who migrates with the intention of being self-supporting.

Empirical studies have shown the importance of total money income, which includes labor, property, and transfer income, in influencing migration. In only a few instances, however, has transfer income been included as a separate variable. Robert Reischauer,²⁰ in explaining black migration from Southern States to urban centers in the North and West, found that welfare opportunities in the South are not strong determinants of the volume of blacks leaving the region. On the other hand, welfare opportunities in the Northern and Western urban areas are significant in explaining migration to these areas. He concludes that factors other than welfare are responsible for blacks fleeing the South, but that the choice of destination and the level of migration are related to welfare opportunities in the North and West.

Reischauer also examines whether welfare encourages people to stay in urban areas even though jobs there are scarce. Does welfare become an acceptable alternative to the low-wage jobs that have moved away? He finds that welfare does not hold blacks in central cities. This conclusion is supported by Lansing and Mueller,²¹ who find that welfare does not reduce mobility.

With inconclusive findings such as these, the burden of proof is on those who believe that welfare has no effect on the decision to migrate. Labor-market conditions clearly influence migration. If earnings are important, the availability of transfer income should also enter the decision. Welfare income is discounted by the probability of needing it and the stigma of receiving it, but it should have some influence. Even if welfare benefits were equal in all areas, the availability of welfare income could increase migration by providing insurance against zero income should job opportunities in the new location be insufficient.

The conclusion to be drawn is that provisions for supplementing a uniform Federal benefit should be designed with some regard for their effect on migration. There is a limit to the differentials by area that can be tolerated if a neutral effect on migration is sought. This is particularly important if a new program provides information on eligibility and payment levels, and recruits people who are eligible. If the Government desired a nonneutral effect on migration, that is, if it were following an explicit policy of population redistribution, welfare benefits could be set to further such a policy.

Area Price and Cost Differentials

Because prices and the cost of living vary from one area of the country to another, a uniform cash benefit would enable recipients in some areas to achieve a higher standard of living than in others. Current Federal income maintenance programs make no distinctions based on area price or cost differentials, nor do Federal taxes. The uniformity of these programs is not generally considered an inequity, at least not relative to the other inequities of the programs. The reasoning behind this position is that people freely choose where they live, and

²⁰ Robert D. Reischauer, "The Impact of the Welfare System on Black Migration and Marital Stability," (unpublished Ph. D. dissertation, Columbia University, 1971).

²¹ John B. Lansing and Eva Mueller, *The Geographic Mobility of Labor*, University of Michigan, 1967, pp. 323-332.

do not have to tolerate relatively high prices and costs unless they choose to do so.

However, the objectives of the Federal anti-poverty programs do provide a justification for area differentials. In these programs, poor education, sickness, and large family size are considered factors over which people have little or no control, and they are not expected to change them as a condition of receiving benefits. The location of a person or family seems to be considered in a similar light: someone living in an area with high costs or few job opportunities is not expected to migrate as a condition of receiving assistance. If the Government considers a family's location to be fixed, then it should make cost-of-living adjustments if its objective is to guarantee a minimum real income.

A program which gives families in all locations enough income to attain the same standard of living or welfare would adjust benefits to reflect differences both in prices and in other factors affecting the cost of living. These include climate, which influences shelter costs and clothing needs, transportation facilities relative to need, the quantity and quality of public services, the type and level of taxation, and recreational opportunities. They vary among warm and cold areas; inner city, suburb, small town, and farm; cities and States with high and low levels of services for the poor; cities and States with income taxes and sales taxes; and other factors.

The Bureau of Labor Statistics (BLS) has developed measures of living costs for 40 metropolitan areas, and for nonmetropolitan areas as a group in the four census regions. Using information from a variety of sources, the BLS estimated the amount and quality of the items needed for a family of a certain size and composition to attain a given standard of living. Food, shelter, transportation, and clothing requirements vary from city to city and among regions. By pricing the set of items in each city, an estimate of the cost of living is obtained.

Table 5 shows cost-of-living indexes based on the BLS lower budget for an urban family of four in 1970. The index ranges from a high of 155 in Anchorage to a low of 88 in nonmetropolitan areas of the South. Many areas fall within a fairly narrow range: 30 of the 44 areas had cost-of-living indexes between 95 and 105. The cost of living in cities is larger than in nonmetropolitan areas, and in many cases this differential is greater than that between regions. For example, the differential between cities in the West and the nonmetropolitan areas of the West is greater than the differential between nonmetropolitan areas in the West and nonmetropolitan areas in the north-central regions. The differential is also large between closely situated cities. A six-point difference and 110 miles separate New York City and Hartford. A five-point difference and 120 miles separate Los Angeles and San Diego.

Unfortunately, use of a cost-of-living index like the one developed by the BLS to adjust income maintenance benefits is not entirely appropriate. The index would only be appropriate if it measured not just the cost of living but the benefits associated with the costs. People living in areas with high State and local taxes receive more public services. High rents may also reflect a greater level of public services. The index would also have to adjust accurately for the varying tastes of people who prefer certain life styles over others. For example, cold climates require higher fuel bills, but someone who enjoys winter sports receives a concomitant benefit.

The BLS assumptions about food preferences are particularly open to question. They assumed that preferences for food vary among regions, and found that food costs in Southern cities were 92 to 95 percent of those for the country as a whole.²² But it is likely that these preferences reflect only the low incomes of people in the South. When food preferences were assumed to be the same for all cities, food costs in Southern cities were very close to the average.²³

²² U.S. Department of Labor, Bureau of Labor Statistics, *City Worker's Family Budget: Pricing, Procedures, Specifications, and Average Prices*, Bulletin No. 1570-3 (autumn 1966).

²³ Watts uses the observed behavior of families rather than the judgment of Government technicians to estimate area cost-of-living differentials. His iso-prop index is based on the notion that families which are equally well off will spend the same proportions of their income on basic necessities. To determine the incomes in varying locations which provide the same level of well-being, he finds those incomes at which people spend the same proportion of their income on necessities. Although this procedure is appropriate under certain assumptions for adjusting for family size differentials, it is not an appropriate way to adjust for area differentials. If a person in a cold climate needs to spend more in order to keep his house at a given temperature, he would not also need to spend more on all other items than someone in a warm climate. If he spent more money on heat and also spent the same proportion of his income on heat as someone in a warm climate, his expenditures on other items and, consequently, his total standard of living, would be higher than someone in a warm climate. Harold W. Watts, "The Iso-Prop Index: An Approach to the Determination of Different Poverty Income Thresholds," *The Journal of Human Resources*, vol. II., No. 1 (winter 1967).

TABLE 5.—*Indexes of comparative costs based on a lower budget for a 4-person family,¹ spring 1970*

[U.S. urban average costs=100]

Area	Total budget	Cost of family consumption							Personal income taxes
		Total	Food	Housing ²	Transportation ³	Clothing and personal care	Medical care ⁴	Other family consumption	
Urban United States-----	100	100	100	100	100	100	100	100	100
Metropolitan areas ⁵ -----	101	101	101	102	95	102	103	104	103
Nonmetropolitan areas ⁶ -----	94	94	93	93	121	93	85	81	88
Northeast:									
Boston, Mass-----	106	106	105	114	100	102	99	108	107
Buffalo, N. Y-----	101	100	105	95	105	102	91	104	105
Hartford, Conn-----	109	109	108	121	102	105	97	111	108
Lancaster, Pa-----	96	96	102	93	93	96	91	95	96
New York-Northeastern N.J-----	103	103	110	97	86	100	106	109	108
Philadelphia, Pa.-N.J-----	100	98	106	90	92	98	97	103	113
Pittsburgh, Pa-----	96	96	102	91	98	96	87	100	98
Portland, Maine-----	102	103	102	108	96	105	96	112	96
Nonmetropolitan areas ⁶ -----	96	97	100	90	128	94	89	80	93
North Central:									
Cedar Rapids, Iowa-----	99	98	95	105	88	105	92	100	104
Champaign-Urbana, Ill-----	104	105	98	122	93	102	99	100	102
Chicago, Ill.-Northwestern Ind-----	104	105	104	107	103	103	105	107	105
Cincinnati, Ohio-Ky.-Ind-----	95	95	99	91	94	100	85	103	92
Cleveland, Ohio-----	102	102	103	99	101	105	99	106	104
Dayton, Ohio-----	96	97	98	94	91	103	88	107	94
Detroit, Mich-----	100	99	104	92	98	102	99	102	104
Green Bay, Wis-----	97	95	92	96	91	107	89	97	115
Indianapolis, Ind-----	102	102	101	106	97	100	99	108	103
Kansas City, Mo.-Kans-----	100	100	101	97	101	105	96	102	101
Milwaukee, Wis-----	102	99	94	104	94	104	96	104	124

Minnneapolis-St. Paul, Minn.....	103	100	98	103	97	104	96	103	124
St. Louis, Mo.-Ill.....	100	100	104	98	104	100	94	101	101
Wichita, Kans.....	97	97	98	101	87	95	96	96	93
Nonmetropolitan areas ⁶	97	97	95	103	119	95	83	82	99
South:									
Atlanta, Ga.....	92	94	92	94	90	96	92	105	80
Austin, Tex.....	89	91	91	85	90	96	98	98	72
Baltimore, Md.....	101	100	95	104	99	100	102	102	112
Baton Rouge, La.....	92	94	96	90	93	95	90	100	77
Dallas, Tex.....	96	97	93	95	91	97	120	105	85
Durham, N.C.....	97	97	91	105	85	97	102	102	102
Houston, Tex.....	93	95	94	90	96	95	107	100	80
Nashville, Tenn.....	91	93	91	94	92	94	89	103	75
Orlando, Fla.....	94	96	90	106	87	91	101	103	82
Washington, D.C.-Md.-Va.....	104	103	99	112	101	96	102	108	115
Nonmetropolitan areas ⁶	88	90	89	86	118	90	82	82	75
West:									
Bakersfield, Calif.....	99	99	99	93	100	103	115	94	90
Denver, Colo.....	96	97	96	89	99	111	97	98	91
Los Angeles-Long Beach, Calif.....	108	107	99	113	101	109	126	101	106
San Diego, Calif.....	103	103	97	105	98	106	118	99	97
San Francisco-Oakland, Calif.....	110	110	102	121	103	111	113	105	111
Seattle-Everett, Wash.....	110	110	107	117	101	112	112	105	108
Honolulu, Hawaii.....	124	120	120	140	110	106	105	109	166
Nonmetropolitan areas ⁶	100	99	96	100	123	104	91	81	110
Anchorage, Alaska.....	155	149	121	205	172	119	157	95	231

¹ The family consists of an employed husband, age 38, a wife not employed outside the home, an 8-year-old girl, and a 13-year-old boy.

² Housing includes shelter, household operations, and housefurnishings. All families with the lower budget are assumed to be renters.

³ The average costs of automobile owners and nonowners are weighted by the following proportions of families: Boston, Chicago, New York, and Philadelphia, 50 percent for both automobile owners and nonowners; all other metropolitan areas, 65 percent for automobile owners, 35 percent for nonowners; nonmetropolitan areas, 100 percent for automobile owners.

⁴ In total medical care, the average costs of medical insurance were weighted by the following proportions: 30 percent for families paying full cost of insurance; 26 percent

for families paying half cost; 44 percent for families covered by noncontributory insurance plans (paid by employer).

⁵ As defined in 1960-61. For a detailed description, see the 1967 edition of the *Standard Metropolitan Statistical Areas*, prepared by the Bureau of the Budget.

⁶ Places with population of 2,500 to 50,000.

Source: U.S. Department of Labor, Bureau of Labor Statistics, *Three Budgets for an Urban Family of Four Persons, 1969-70*, supplement to Bulletin 1570-5.

Given that the technical judgments used to develop a BLS-type index cannot take differing tastes into account, it might be better to adjust benefits only for differences in prices. Price levels can be estimated with considerably more objectivity. The choice of which bundle of commodities to use as weights in the index requires some assumptions concerning tastes, but not as many as needed for the BLS cost-of-living index. An index calculated by pricing the same bundle of goods in various regions is shown in table 6. As would be expected, the variation in this price index is smaller than the variation in the cost-of-living index.

These price indexes reveal another difficulty which must be faced in adjusting cash benefits. The price variation within regions is larger than the variation among them. Price-level adjustments between closely situated areas would adjust for a great deal of the total variation, but it is precisely these adjustments which could most easily influence migration. In dividing the country into the price-level areas, therefore, there is a tradeoff between the accuracy of the price-level adjustment and the minimization of its effect on migration. Because prices vary within regions, the smaller the area adjusted for the more accurate the measurement. On the other hand, the smaller the area the smaller the cost of moving from one to another.

TABLE 6.—*Price index based on the Bureau of Labor Statistics lower budget for a 4-person family, spring 1970*¹

	Nonmetropolitan areas	Metropolitan areas			Total All urban areas
		Population 50,000 to 1,000,000	Population 1,000,000 and over	All metropolitan areas	
South.....	93	99	100	99	97
Northeast.....	92	98	100	100	99
North Central.....	95	99	102	101	100
West.....	98	99	108	106	105
Urban United States...	94	99	102	101	100

¹ The price index was calculated using metropolitan area average quantity weights for all locations.

Source: Unpublished table received from the Bureau of Labor Statistics.

If the Federal Government decides that price-level differences are large enough to warrant the costs of surveys to measure the differences and the migration that might result from varying benefit levels, the Federal benefit could be adjusted to take the differential into account. Payments made to families with no income could vary in direct proportion to the price index for the area. The 100 percent disregard under H.R. 1 could be varied accordingly, although it might not be worth sacrificing the simplicity of the program for such a small amount. The tax rate on earnings under H.R. 1 and the demogrant would be the same for all areas. Public employment wages could also be varied in proportion to the price index.

Structuring State Supplements To Be Consistent With Federal Programs

Many people would receive less under the three proposed alternative programs than under the current public assistance programs, as was shown in the first section of this paper. Even if the Federal benefits.

were adjusted for differences in the cost of living, people in many States would continue to be worse off. It is, therefore, likely that some States would desire to supplement the Federal benefit. Regardless of whether or not it is economically efficient for States to supplement,²⁴ a Federal law prohibiting supplementation would probably be unconstitutional. Assuming that States will supplement, what should be the policy of the Federal Government toward supplementation?

The Federal role in financing State supplements will be discussed in the next section. The concern here is with the constraints that the Federal Government should place on the States so that the supplements are consistent with the objectives of the Federal program. Specifically, States should not be permitted to reduce the incentives provided by the Federal benefit schedule for work or for family stability.

To maintain work incentives, the State supplement should not increase the tax rate implicit in the Federal benefit. An example illustrates how this could be done. If the Federal Government paid benefits according to the schedule in H.R. 1 and a State had an AFDC payment standard of \$3,000, the State would have to disregard all income below \$4,320 and tax the remainder at 67 percent. This is shown in table 7. In order to preserve the work incentives of the Federal program, the States must also give supplements to people with earnings between the Federal breakeven of \$4,320 and the State breakeven of \$5,220. If they do not, these people could obtain higher total incomes by reducing their earnings below \$4,320.

TABLE 7.—*State supplement required to keep tax rate of Federal program unchanged*

Earnings	Federal benefit under H. R. 1	State supplement	Total income	Marginal tax rate
\$0	\$2, 400	\$600	\$3, 000	0
720	2, 400	600	3, 720	$\frac{2}{3}$
1, 000	2, 213	600	3, 813	$\frac{2}{3}$
2, 000	1, 546	600	4, 146	$\frac{2}{3}$
3, 000	879	600	4, 479	$\frac{2}{3}$
4, 320	0	600	4, 920	$\frac{2}{3}$
4, 620	0	400	5, 020	$\frac{2}{3}$
4, 920	0	200	5, 120	$\frac{2}{3}$
5, 220	0	0	5, 220	$\frac{2}{3}$

²⁴ For a more complete discussion of this see James M. Buchanan and Richard E. Wagner, "An Efficiency Basis for Federal Fiscal Equalization," in Julius Margolis, ed., *The Analysis of Public Output* (New York City: National Bureau of Economic Research, 1970). If the residents of a State prefer a greater degree of income redistribution than the country as a whole, their well-being is greater if the additional redistribution is permitted. Whether supplementation leads to economic efficiency in the economy as a whole cannot be determined a priori. A supplement will tend to reduce outmigration of low-skilled people and to increase immigration of low-skilled people from other States. Whether this is efficient depends on the productivity of labor in the supplementing States relative to productivity of labor in other States and the externalities resulting from population levels and shifts. It is likely that States which supplement will have higher incomes than those which do not. This means that the supplementation will attract unskilled labor into areas where their productivity is greater, thereby increasing total output. It is difficult to generalize about whether these higher income States would experience positive or negative externalities due to a larger population.

H.R. 1 requires that State supplements given to families who receive Federal benefits do not increase the tax rate of the Federal program: a family of four with income below \$4,320 cannot have its income taxed at a rate above two-thirds. This means that the State supplement cannot decline as earnings rise from \$0 to \$4,320. But if the family's income is above \$4,320, the State can tax it at 100 percent.²⁵ This would permit the States to tax AFDC recipients at a considerably higher rate than they do now.

The Senate Finance Committee proposal would also prevent the State supplements from undermining the work incentives of the Federal program. State benefits would have to be computed under the assumption that individuals eligible to participate in the Federal employment program are actually participating and receiving \$200 a month. That is, someone who is eligible to work but not actually working would receive the same supplement as someone earning \$200. The State would also have to disregard completely all earnings between \$200 and \$367 of someone employed full time at \$2 an hour. Beyond this income, the States are free to use any tax rate they choose.

The incentives for family stability provided by the Federal program can be preserved by paying supplements to all people eligible for the Federal benefits. If families headed by men are eligible for Federal benefits but not for the State supplement, the Federal program would be undermined. The State supplement should also adjust payments for family size in a similar, although not necessarily identical, way as the Federal program. For example, if a demogrant bases payments solely on the ages of the family members, the supplement should not introduce incentives for family splitting by making payments for each child decline with the number of children in the family.

The provisions for State supplementation in H.R. 1 and the Senate Finance Committee plan counter the incentives for family stability embodied in the Federal payment structures. They permit the States virtually to reestablish the AFDC program on top of the uniform Federal benefit structure. Under H.R. 1, States could exclude families with both parents present and able to work, regardless of whether they are actually employed, or it could exclude families where the father is actually employed full time. The Senate Finance Committee proposal would also permit States to restrict supplements to families headed by women. That is, States would have the option of extending aid to all families or of maintaining the existing public assistance categories.

In these provisions regarding the tax rate and coverage of the State supplements, Congress was being sensitive to the pressures on the States. They realized that welfare recipients whose new Federal benefits would be less than under AFDC would come to the States

²⁵ The bill is ambiguous about the tax rate which the States may impose on families with incomes above the Federal breakeven point. Section 2156(b)(1)(B) was intended to mean that the States could not impose a tax rate of more than 100 percent on families with incomes above the Federal breakeven. However, the language of the section is not precise and has been interpreted by some to mean that the States could cease supplementing a family as soon as its income rose above the Federal breakeven point. That is, the State supplement could stay constant as earnings rose from \$0 to \$4,320 and could fall to zero as earnings rose to \$4,321. This would imply a tax rate of well over 100 percent and would provide an incentive for families to keep their income below \$4,320 and continue to receive the supplement.

asking for supplementation. For the States to deny them would be politically unpopular, but to supplement all recipients under H.R. 1 or the committee plan would be costly. Permitting States to perpetuate the categories and raise the tax rate relieves States of this predicament. However, it makes a mockery of H.R. 1 or the committee plan as a "welfare reform" bill.

Federal Financing of State Supplements: Adjustment to the New Benefit Level

If the Federal Government pays a uniform benefit to people in all States, adjusted perhaps for differences in price levels, is there any reason why it should also help finance State supplements? It can be argued that using Federal funds to encourage State supplementation would result in more total funds being given to the poor. On the other hand, it can also be argued that the Federal Government's desire to give money to the poor is satisfied by the uniform Federal benefit and that the people of States which choose not to supplement should not be made to share in the cost of the other States' supplements. There is no unequivocal answer to this question; it depends on which States choose to supplement and by how much.²⁶

There is a more clear-cut justification for temporary Federal aid to the States following the introduction of a program like H.R. 1 or the demogrant. If neither the States nor the Federal Government supplements the uniform Federal payment under a new program, many recipients will be worse off than before. They can object validly that they have become accustomed to a certain level of income, and that a sudden drop will cause temporary difficulties as they adjust to the lower level.

Welfare recipients will look to the States to supplement the Federal benefits. If the States do so, and prevent recipients from being worse off, the States themselves might be worse off. That is, the cost of supplementing the Federal benefit may be greater than present State and local expenditures for public assistance. States will argue, justifiably, that the Federal Government has suddenly reduced its support, and that they should be compensated for such a change in policy.

The Federal Government, rather than the States, could assume responsibility for temporary supplementation while recipients adjust to a lower benefit level. This would have the advantage of putting no

²⁶ The desirability of Federal grants to States for this purpose depends upon whether the grants increase economic efficiency and interpersonal equity. A grant will be accompanied by some combination of an increase in State supplements and a decrease in State taxes. This will tend to encourage migration into the State. The grant increases efficiency if the induced migration is from States where labor productivity is low to where it is high, and if it provides incentives which reduce undesirable externalities. The equity of the grant depends upon whether it equalizes the welfare of individuals in similar circumstances living in different States.

The richer States are more likely to supplement the Federal benefits than are the lower-income States. Grants to higher-income States will be efficient if they encourage migration to these States and if this is not offset by externalities resulting from crowding. However, grants to high-income States will tend to be inequitable by increasing the disparity in income levels between people in high- and low-income States. This will be offset, to some degree, if people in the lower-income States desire that the higher-income States supplement. They will then experience an increase in well-being which will compensate them for the higher taxes required to finance the grant made to the higher-income States.

added financial pressure on those States where the cost of supplementation would be greater than previous State and local expenditures for public assistance. On the other hand, the Federal Government might be amenable to pressures to continue paying the supplements after the adjustment period. Furthermore, because public assistance benefits are determined by a complex procedure, with a high degree of administrative discretion, the Federal Government would have difficulty in paying recipients an amount which would leave them as well off as under public assistance. The Federal Government could most easily provide supplements equal to some *average* difference between the public assistance payments and the new program. But this means a significant change in benefits for individual families, and would make the supplement less effective in helping recipients adjust gradually to the lower benefit levels.

Assuming, then, that the States administer the temporary supplement, how should the Federal Government help finance it? Matching grants could be given which would depend on the amount of supplementation and thereby reduce the cost to the States of giving an additional dollar of welfare, as do the current matching formulas used in public assistance. The reduced price would provide an incentive for the States to supplement the Federal benefits, and the greater the price reduction, the greater the incentive. There is no guarantee that the States would supplement up to the current level of public assistance payments, even if the price to the States were reduced to zero. But it is difficult to see why States should refuse to supplement if the price to them is no more than the price of public assistance now.

The danger in reducing the price to the States is probably not that they will supplement inadequately, but that they will supplement beyond the present level of welfare benefits.²⁷ In order to prevent this, it would be necessary to impose a limit on the amount of Federal matching. This limit, of course, would have to vary from State to State. Defining such a limit would require either that the Federal Government determine what the States' public assistance payment levels are, which we have argued above would be a large task, or that the limit be based on criteria other than public assistance payment levels.

Another approach would be to give grants to the States which would not depend on the amount of supplementation and, therefore, would not reduce the price to the States of paying an additional dollar. These flat grants would be based on some other criteria such as (a) the difference between the Federal grant under PA and the new Federal benefits to recipients in the former welfare categories; or (b) the State's ability to pay the supplements. The grants would encourage States to pay supplements because of the increased revenues available to them. But because the grant would be fixed and would not increase with the amount of supplementation, States would not be encouraged to supplement far beyond the present level of welfare benefits. The drawback to this approach is that States might not supplement enough to prevent welfare recipients from being worse off than under public

²⁷ This may or may not be desirable, as discussed earlier in note 24. If the objective of the grant is to encourage the States to supplement so that recipients can adjust gradually to a lower level of benefits, then the States should be discouraged from supplementing beyond the present level of welfare benefits.

assistance. States could be required to supplement a certain amount as a condition of receiving the grant, but it would be difficult for the Federal Government to insure that they supplement just enough to leave no one worse off.

The choice between a matching grant and a flat grant depends, in large part, on the extent to which the purpose of Federal financial support is to protect welfare recipients against lower incomes, or to protect the States against higher costs. A matching grant, if the Federal share is large enough, would be likely to induce the States to maintain the incomes of welfare recipients at their previous levels. The cost of this approach is the possibility that States will make higher payments than before. A flat grant would not provide as strong an incentive to maintain the income of recipients, but would also not create the possibility of increasing State supplements.

The choice between a matching and flat grant requires an estimation of the political power of welfare recipients. Assume the Federal Government made flat grants which equaled the excess of previous Federal grants for public assistance over the new Federal benefits to recipients in the former welfare categories. These grants would be appropriate if welfare recipients had enough power to pressure the States to maintain their incomes at the former level, given that this would impose no additional cost to the States. If, on the other hand, one believes that the States would not use the flat grant to help recipients to adjust to a lower level of benefits, a matching grant would be more appropriate.

Under H.R. 1, the Federal Government would provide financial support for State supplementation on a limited basis, and only on the condition that the Federal Government administer the supplement.

The amount of the supplement which the Federal Government would pay depends on a complicated set of rules involving the previous level of a State's welfare benefits and the State's total welfare expenditures. If a State supplements the Federal benefit below or up to a certain level, called the "adjusted payment level," the State is guaranteed that for 5 years after the beginning of H.R. 1 it will not have to spend more for welfare than it did in 1971. The State would pay 100 percent of the cost until its expenditures reached the 1971 level, and the Federal Government would pay all the remainder. But the Federal Government would not absorb any of the costs of the supplements above the adjusted payment level. Nor would it pay the cost of extending the supplements to families outside of the State's previous AFDC categories.

The adjusted payment level is the amount of money an individual or family (of a given size) with no other income would have received in January 1971. At its option, the State could increase this amount by the bonus value of food stamps, in order to compensate H.R. 1 recipients for their loss of eligibility for food stamps. The adjusted payment level could not include the amounts given for special needs.

States, therefore, would fall into three categories. In five States, according to estimates in the House report on H.R. 1, the Federal benefits would be greater than the combined value of public assistance benefits and the bonus value of food stamps. Former welfare recipients would be made better off by H.R. 1, and the States would be under no great pressure to supplement. If the States decided to supplement, they

would have to pay the full cost of doing so. In light of the discussion at the beginning of this section, this appears appropriate.

In 21 States, Federal benefits under H.R. 1 would be less than public assistance benefits and the bonus value of food stamps, but State supplementation to prevent recipients from being worse off would cost less than the State's previous welfare expenditures. These States would not qualify for a Federal grant, and they would have to pay the full cost of supplementation. But because this would cost them less than their previous welfare program, they could not complain that a sudden change in Federal policy had left them in a tight financial situation. According to the argument made above, it is appropriate that these States receive no Federal aid.

The remaining 25 States would face higher costs if they supplemented so that no one became worse off than under public assistance. Under H.R. 1 they would have to pay the full cost of the supplements until their expenditures were as large as in 1971, and the Federal Government would pay 100 percent of the remaining cost up to the adjusted payment level. Because the States would not have to pay anything for the marginal dollar required to maintain former welfare recipients at the adjusted payment level, they would be likely to make supplements up to that level. Guaranteeing recipients the adjusted payment level would not, however, make everyone as well off as under public assistance. The adjusted payment level is based on the payment given to families with no income. Families with income would receive less than under public assistance because the deductions permitted in determining the supplement would be less than under public assistance. Families with special needs would also receive less if they were paid according to the adjusted payment level.²⁸

The Senate Finance Committee plan would not require the Federal Government to administer State supplements as a condition for financial support. However, it would put strict limits on the amount of Federal grants to the States. For the adult categories, the Federal Government would pay the full cost of meeting the federally required payment levels for a State's *existing* caseload or, if greater, the State's share of \$5 billion distributed among States proportionate to the number of aged individuals with incomes below specified levels in 1969. This amount would be fixed over time. If the caseload increased, the Federal Government would pay 90 percent of the State costs of meeting the federally required payment level. It would pay nothing for assistance paid above the federally required levels.

Federal financial support for AFDC would be a block grant adjusted over time only for changes in a State's population. The grant would equal the Federal grant for AFDC in 1972 plus one-half of the State costs in 1972 or, if less, the amount needed in 1972 to bring welfare families' income up to \$1,600 for a family of two, \$2,000 for a family of three, and \$2,400 for a family of four or more. The grant would be

²⁸ According to congressional estimates, Federal benefits under the program of supplemental security income for the aged, blind, and disabled would be greater than the combined value of public assistance and the bonus value of food stamps in 20 States. In 10 States, Federal benefits would be less than the combined value of public assistance and the food stamp bonus, but the cost of a supplement to bring total benefits up to this level would be less than the States' present expenditure. The remaining 21 States would qualify for Federal grants if they wished to supplement to maintain current benefit levels, provided that the supplements were administered by the Federal Government.

reduced by an unspecified amount after the employment program became effective in 1974, to reflect the fact that families with children age 6 or more would be ineligible for AFDC. After that time, the grant would only be changed to reflect changes in the State's total population.

Compared with H.R. 1, the committee's grant formulas have the advantage of being unambiguous about the level of State payments which the Federal Government would support, and the Federal Government would be relieved of the administrative burden of making complicated calculations regarding how much of the State payments would be subject to Federal support. Compared with H.R. 1, where the Federal Government would pay the full cost in 25 States of supplements between the States' expenditures in 1971 and the "adjusted payment level," the committee plan would provide less incentive for the States to supplement recipients to keep them from becoming worse off than they currently are.

Special Needs

Under public assistance, caseworkers have a certain amount of discretion under the State's regulations to give recipients additional money if they have unusual demands on their income. In contrast, Federal benefits under H.R. 1, a demogrant, and the Senate Finance Committee plan would be uniform, based on the presumed need of an average person. While the elimination of administrative discretion in the proposed programs reduces the potential for inequitable treatment, it also removes some desirable flexibility. What would someone do if his house burned down? What would a blind person do who could not manage for himself and required an attendant or boarding home care?

It seems clear that the income maintenance system should retain the flexibility to help people with unusual needs and that this requires administrative discretion exercised at the local level. State supplements for special needs are an appropriate method of providing this flexibility. The question remains whether Federal financing is appropriate and, if so, how financing can be limited so that payments for special needs do not become a general supplement to the Federal benefit.

Federal financing is appropriate if the objective of a federally provided minimum income is to guarantee people a minimum level of well-being. Attaining such a level depends on having enough income relative to the demands on it. We recognize that income relative to demands is the relevant criterion when we adjust benefits for age or family size. In much the same way, extraordinarily large needs over which people have no control increase the income required to attain a given level of well-being.

The problem is that special needs cannot be defined as clearly as can age or family size. What may appear to one administrator as an uncontrollable demand on a family's income may not be considered so by another. But the fact that administrators may not agree on what constitutes a special need should not end all Federal efforts to help persons in unfortunate situations.

While Federal offices could be set up in the localities, it would be more efficient for State or local agencies to provide such assistance.

Federal grants could be made to the States based on the number of low-income persons in the State, the assumption being that each person has the same chance of having a special need. The choice between flat or matching grants up to some amount depends on whether it is considered desirable to use Federal funds to encourage some States to spend more on the poor or to spread the funds evenly among the poor in all States.

CONCLUSIONS

If the Federal Government initiates a program providing benefits in the range discussed here—\$1,200 to \$1,800 for an adult and \$2,400 to \$3,600 for a family of four—many people will be worse off than they are under the current public assistance programs (of course, many people will be better off, but that is not the focus here). The changes will be large in some cases, and will vary enormously from one family to another depending on the family's sources of income, types of expenditures, special needs, the area it lives in and, to some extent, on its caseworker. Over time, Federal benefits may grow to be as large as current public assistance benefits in the high benefit States. And, certainly, normal caseload turnover will minimize long-term losses for individual families. But in the interim, States will be under great pressure to supplement the Federal payments.

Whether or not the Federal Government should build interstate differentials into the Federal benefit structure or help finance State supplements depends on several factors. Adjusting the Federal benefits for area differences in price level is justified by the goals of a Federal transfer program to reduce poverty and would, as a by-product, cushion some recipients against a drop in benefits. However, because prices vary among closely situated areas, accurate price adjustments would create incentives to migrate which might be undesirable. It is also questionable where the magnitude of the price differentials warrants the administrative cost of adjusting for them.

In the relatively short run, until recipients have adjusted to lower benefit levels, or the States which desire to supplement have adjusted to higher welfare costs, Federal grants to the States for supplementation appear appropriate. However, Federal grants for the purpose of helping the States through a transitional period should not be allowed to encourage them to make greater supplements. This means that funds given to the States should be in the form of block, rather than matching, grants.

Whether Federal grants to the States for supplementation should be made a permanent feature of the system has not been resolved here. Grants to the States for the types of special needs discussed in the last section seem appropriate. The system should retain flexibility to help people in unusual circumstances and this can best be done at the local level. However, it is less certain that grants should be made to States for general supplementation of the uniform Federal benefit. If the country had an explicit policy for redistributing the population, grants would be an appropriate tool or encouraging migration. But a strong case cannot be made for grants to the States for supplementation solely to improve the distribution of income among individuals.

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